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No. 12796

United States
Court of Appeals
for the Ninth Circuit.

BORK MANUFACTURING CO., INC., a Corporation, and ALVIN BORKIN, an Individual and President of Bork Manufacturing Co., Inc.,

Petitioners,

vs.

FEDERAL TRADE COMMISSION,

Respondent.

Transcript of Record

Petition to Review an Order of The Federal Trade Commission

FILED
MAR 12 1954
PAUL P. O'BRIEN,
CLERK

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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APPEARANCES

JOHN W. BROOKFIELD, JR.,

Attorney supporting the Complaint.

MAXWELL SLOTE,

Attorney for the Bork Manufacturing Co.

United States of America
Before Federal Trade Commission

Docket No. 5525

In the Matter of

BORK MANUFACTURING CO., INC., a Corporation, and ALVIN BORKIN, an individual and President of Bork Manufacturing Co., Inc.

COMPLAINT

Pursuant to the provisions of the Federal Trade Commission Act, and by virtue of the authority vested in it by said Act, the Federal Trade Commission, having reason to believe that Bork Manufacturing Company, Inc., and Alvin Borkin, an individual, and president of Bork Manufacturing Co., Inc., hereinafter referred to as respondents, have violated the provisions of said Act, and it appearing to the Commission that a proceeding by it in respect thereof would be in the public interest, hereby issues its complaint and states its charges in that respect as follows:

Paragraph One: Respondent, Bork Manufacturing Co., Inc., is a corporation organized and doing business under and by virtue of the laws of the State of New York, with its principal office and place of business located at 6201 15th Avenue, in the City of Brooklyn, New York. Respondent, Alvin Borkin, is an individual, and president of said corporate respondent and controls and directs the business activities, sales policies and practices of the

corporate respondent. The respondents have acted in conjunction and cooperation with each other in carrying out the acts and practices hereinafter alleged. Respondents are now and for more than three years last past have been engaged in the manufacture of devices commonly known as push cards and punch boards, and in the sale and distribution of said devices to manufacturers of, and dealers in various articles of merchandise in commerce between and among the various states of the United States, and in the District of Columbia.

Respondents cause and have caused said devices when sold, to be transported from their place of business in the State of New York to purchasers thereof at their points of location in the various states of the United States other than New York, and in the District of Columbia. There is now and has been for more than three years last past a course of trade in such devices by said respondents in commerce between and among the various states of the United States and in the District of Columbia.

Paragraph Two: In the course and conduct of their said business as described in Paragraph One hereof, respondents sell and distribute, and have sold and distributed, to said manufacturers of and dealers in merchandise, push cards and punch boards so prepared and arranged as to involve games of chance, gift enterprises or lottery schemes when used in making sales of merchandise to the consuming public. Respondents sell and distribute, and have sold and distributed many kinds of push

cards and punch boards, but all of said devices involve the same chance or lottery features when used in connection with the sale or distribution of merchandise and vary only in detail.

Many of said push cards and punch boards have printed on the faces thereof certain legends or instructions that explain the manner in which said devices are to be used or may be used in the sale or distribution of various specified articles of merchandise. The prices of the sales on said push cards and punch boards vary in accordance with the individual device. Each purchaser is entitled to one punch or push from the push card or punch board, and when a push or punch is made a disc or printed slip is separated from the push card or punch board and a number is disclosed. The numbers are effectively concealed from the purchasers and prospective purchasers until a selection has been made and the push or punch completed. Certain specified numbers entitle purchasers to designated articles of merchandise. Persons securing lucky or winning numbers receive articles of merchandise without additional cost at prices which are much less than the normal retail price of said articles of merchandise. Persons who do not secure such lucky or winning numbers receive nothing for their money other than the privilege of making a push or punch from said card or board. The articles of merchandise are thus distributed to the consuming or purchasing public wholly by lot or chance.

Others of said push card and punch board devices have no instructions or legends thereon but

have blank spaces provided therefor. On those push cards and punch boards the purchasers thereof place instructions or legends which have the same import and meaning as the instructions or legends placed by the respondents on said push card and punch board devices first hereinabove described. The only use to be made of said push card and punch board devices, and the only manner in which they are used, by the ultimate purchasers thereof, is in combination with other merchandise so as to enable said ultimate purchasers to sell or distribute said other merchandise by means of lot or chance as hereinabove alleged.

Paragarph Three: Many persons, firms and corporations who sell and distribute, and have sold and distributed candy, cigarettes, clocks, razors, cosmetics, clothing and other articles of merchandise in commerce between and among the various states of the United States and in the District of Columbia, purchase and have purchased respondents' said push card and punch board devices, and pack and assemble, and have packed and assembled, assortments comprised of various articles of merchandise together with said push cards and punch board devices. Retail dealers who have purchased said assortments either directly or indirectly have exposed the same to the purchasing public and have sold or distributed said articles of merchandise by means of said push cards and punch boards in accordance with the sales plan as described in Paragraph Two hereof. Because of the element of chance involved in connection with the

sale and distribution of said merchandise by means of said push cards and punch boards, many members of the purchasing public have been induced to trade or deal with retail dealers selling or distributing said merchandise by means thereof. As a result thereof many retail dealers have been induced to deal with or trade with manufacturers, wholesale dealers and jobbers who sell and distribute said merchandise together with said devices.

Paragraph Four: The sale of merchandise to the purchasing public through the use of, or by means of, such devices in the manner above alleged, involves a game of chance or the sale of a chance to procure articles of merchandise at prices much less than the normal retail price thereof and teaches and encourages gambling among members of the public, all to the injury of the public. The use of said sales plan or methods in the sale of merchandise and the sale of merchandise by and through the use thereof, and by the aid of said sales plan or method is a practice which is contrary to an established public policy of the Government of the United States and in violation of criminal laws, and constitutes unfair acts and practices in said commerce.

The sale or distribution of said push cards and punch board devices by respondents as hereinabove alleged supplies to and places in the hands of others the means of conducting lotteries, games of chance or gift enterprise in the sale or distribution of their merchandise. The respondents thus supply to, and place in the hands of, said persons, firms and

corporations the means of, and instrumentalities for, engaging unfair acts and practices within the intent and meaning of the Federal Trade Commission Act.

Paragraph Five: The aforesaid acts and practices of respondents as hereinabove alleged are all to the prejudice and injury of the public and constitute unfair acts and practices in commerce within the intent and meaning of the Federal Trade Commission Act.

Wherefore, The Premises Considered, the Federal Trade Commission on this 9th day of January, A.D., 1948, issued its complaint against these respondents.

NOTICE

Notice is hereby given you, Bork Manufacturing Co., Inc., a corporation, and Alvin Borkin, an individual and president of Bork Manufacturing Co., Inc., respondents herein, that the 13th day of Febraury, A.D., 1948, at 2 o'clock in the afternoon, is hereby fixed as the time, and the offices of the Federal Trade Commission in the City of Washington, D. C., as the place, when and where a hearing will be had on the charges set forth in this complaint, at which time and place you will have the right, under said Act, to appear and show cause why an order should not be entered by said Commission requiring you to cease and desist from the violations of the law charged in the complaint.

You are notified and required, on or before the twentieth day after service upon you of this com-

plaint, to file with the Commission an answer to the complaint. If answer is filed and if your appearance at the place and on the date above stated be not required, due notice to that effect will be given you. The Rules of Practice adopted by the Commission with respect to answers or failure to appear or answer (Rule VIII) provide as follows:

> In case of desire to contest the proceeding the respondent shall, within twenty (20) days from the service of the complaint, file with the Commission an answer to the complaint. Such answer shall contain a concise statement of the facts which constitute the ground of defense. Respondents shall specifically admit or deny or explain each of the facts alleged in the complaint, unless respondent is without knowledge, in which case respondent shall so state.
>
> * * *
>
> Failure of the respondent to file answer within the time above provided and failure to appear at the time and place fixed for hearing shall be deemed to authorize the Commission, without further notice to respondent, to proceed in regular course on the charges set forth in the complaint.
>
> If respondent desires to waive hearing on the allegations of fact set forth in the complaint and not to contest the facts, the answer may consist of a statement that respondent admits all the material allegations of fact charged in the complaint to be true. Such answer will

constitute a waiver of any hearing as to the facts alleged in the complaint and the Commission may proceed to make its findings as to the facts and conclusions based upon such answer and enter its order disposing of the matter without any intervening procedure. The respondent may, however, reserve in such answer the right to other intervening procedure, including a hearing upon proposed conclusions of fact or law, in which event he may in accordance with Rule XXIV file his brief directed solely to the questions reserved.

Upon request made within fifteen (15) days after service of the complaint, any party shall be afforded opportunity for the submission of fact, arguments, offers of settlement or proposals of adjustment where time, the nature of the proceeding and the public interest permit, and due consideration shall be given to the same. Such submission shall be in writing. The filing of such request shall not operate to delay the filing of the answer.

In Witness Whereof, the Federal Trade Commission has caused this, its complaint, to be signed by its Secretary and its official seal to be hereto affixed, at Washington, D. C., this 9th day of January, A.D. 1948.

By the Commission.

[Seal]: /s/ OTIS B. JOHNSON,
Secretary.

Before Federal Trade Commission

[Title of Cause.]

ANSWER

Come now the respondents above named, and in answer to the complaint on file herein, admit, deny, and allege as follows, to wit:

1. Answering paragraph one of said complaint the respondents deny that Alvin Borkin controls and directs the policies of the said Bork Manufacturing Co., inc. It it further denied that in the sale and distribution of their merchandise that they sell and distribute to manufacturers of and dealers in various articles of merchandise.

2. These respondents deny all of the material allegation contained in paragraph two, three, four and five of said complaint.

BORK MANUFACTURING CO., INC.,

By /s/ MAXWELL SLOTE,
Attorney for Respondents.

Received January 30, 1948.

Before Federal Trade Commission

At a regular session of the Federal Trade Commission, held at its office in the City of Washington, D. C., on the 9th day of September, A.D., 1948. Commissioners:

Robert E. Freer, Chairman
Garland S. Ferguson
Ewin L. Davis
William A. Ayres
Lowell B. Mason

[Title of Cause.]

ORDER APPOINTING TRIAL EXAMINER AND FIXING TIME AND PLACE FOR TAKING TESTIMONY

This matter being at issue and ready for the taking of testimony and the receipt of evidence, and pursuant to authority vested in the Federal Trade Comimssion,

It Is Ordered that W. W. Sheppard, a Trial Examiner of this Commission, be and he hereby is designated and appointed to take testimony and receive evidence in this proceeding and to perform all other duties authorized by law;

It Is Further Ordered that the taking of testimony and the receipt of evidence begin on Thursday, September 23, 1948, at ten o'clock in the forenoon of that day (Daylight Saving Time), in Room 500, 45 Broadway, New York, New York.

Upon completion of the taking of testimony and receipt of evidence in support of the allegations of

the complaint, the Trial Examiner is directed to proceed immediately to take testimony and evidence on behalf of the respondents. The Trial Examiner will then close the taking of testimony and evidence and, after all intervening procedure as required by law, will close the case and make and serve on the parties at issue a recommended decision which shall include recommended findings and conclusions, as well as the reasons or basis therefor, upon all the material issues of fact, law, or discretion presented on the record, and an appropriate recommended order; all of which shall become a part of the record in said proceeding.

By the Commission:

[Seal] /s/ OTIS B. JOHNSON,
Secretary.

Before Federal Trade Commission

[Title of Cause.]

NOTICE OF HEARINGS

Pursuant to Commission order dated September 9, 1948, hearing for the purpose of taking testimony and receiving evidence in support of the allegations of the complaint in the above matter has been set for September 23, 1948, 10 a.m. D.S.T., Room 500, 45 Broadway, New York, New York.

Please take notice that an additional hearing for the same purpose is hereby set for September

27, 1948, 10 a.m. EST., Room 308, Main Post Office Building, Providence, Rhode Island.

/s/ W. W. SHEPPARD,
Trial Examiner.

September 13, 1948.

To: Maxwell Slote, Esq., 350 5th Avenue, New York, 1, New York.
John W. Brookfield, Jr., Esq., Federal Trade Commission.

Before Federal Trade Commission

[Title of Cause.]

MOTION TO WITHDRAW ANSWER AND SUBSTITUTE ADMISSION ANSWER

Comes now the respondents Bork Manufacturing Co., Inc., and Alvin Borkin, an individual, being the president of said corporation; and move that they be permitted to withdraw the answer filed herein January 30, 1948 and to file the admission answer dated September 22, 1948, and annexed hereto.

Dated: New York, N. Y., September 22, 1948.

BORK MANUFACTURING CO., INC.,

ALVIN J. BORKIN,
President.

By /s/ MAXWELL SLOTE,
Attorney.

Motion concurred in.

/s/ J. W. BROOKFIELD,
Atty. Supporting Complaint.

Received March 14, 1950.

Before Federal Trade Commission

[Title of Cause.]

ANSWER

Comes now the Respondents Bork Manufacturing Co., Inc., a Corporation, and Alvin J. Borkin, an individual and President of Bork Manufacturing Co., Inc., and answering the complaint in this matter, admit all the material allegations of fact charged in said complaint;

Respondents while admitting the facts alleged in said complaint does not admit that said facts constitute a violation of the Federal Trade Commission Act and reserves the right to file a brief within 60 days of the filing of this answer.

/s/ MAXWELL SLOTE,
Attorney for Respondents.

Before Federal Trade Commission

[Title of Cause.]

ORDER CLOSING CASE BEFORE TRIAL EXAMINER AND TRANSMITTING CONSENT ANSWER TO THE COMMISSION

Respondents having been granted permission by the Trial Examiner to withdraw their original answer and substitute therefor an answer admitting all the material allegations in the complaint, and there being no testimony taken, and respondents waiving the Recommended Decision by the Trial Examiner and all intervening procedures,

It Is Ordered that this case be, and the same hereby is, closed for further proceedings before the Trial Examiner as of March 14, 1950.

It Is Further Ordered that under the provisions of Rule XXII, respondents' consent answer undated, filed subject to the condition that any order entered herein be held in abeyance pending final determination of the matter of Harlich Manufacuring Company, Docket No. 4879, and the record herein be, and the same hereby are, transmitted to the Commission for such action as it may deem appropriate.

/s/ W. W. SHEPPARD,
Trial Examiner.

Dated: March 14, 1950.

Received March 14, 1950.

Before Federal Trade Commission

Commissioners: James M. Mead, Chairman
William A. Ayres
Lowell B. Mason
John Carson

[Title of Cause.]

FINDINGS AS TO THE FACTS AND CONCLUSION

Pursuant to the provisions of the Federal Trade Commission Act the Federal Trade Commission, on January 9, 1948, issued and subsequently served its complaint in this proceeding upon respondents, Bork Manufacturing Co., Inc., a corporation, and Alvin Borkin, individually and as president of such corporation, charging said respondents with the use of unfair acts and practices in commerce in violation of the provisions of that Act. After the filing by respondents of their answer to the complaint the trial examiner, theretofore duly designated by the Commission to perform in this proceeding the duties authorized by law, by order in which reference is made to respondents' waiver of further intervening procedure and the filing by the trial examiner of recommended decision granted respondents' motion for permission to withdraw said answer and substitute therefor an answer admitting all of the material allegations of fact set forth in the complaint and reserving in such answer to respondents the right to file brief herein within sixty (60) days after the

filing thereof, which substitute answer was duly filed on March 14, 1950, in the office of the Commission.

Thereafter, this proceeding regularly came on for final hearing before the Commission on the complaint and respondents' substitute answer (no brief having been filed by respondents); and the Commission, having duly considered the matter and being now fully advised in the premises, finds that this proceeding is in the interest of the public and makes this its findings as to the facts and its conclusion based thereon.

Findings as to the Facts

Paragraph One: Respondent, Bork Manufacturing Co., Inc., is a corporation organized and doing business under and by virtue of the laws of the State of New York, with its principal office and place of business located at 6201 15th Avenue, in the city of Brooklyn, New York. Respondent, Alvin Borkin, is an individual, and president of said corporate respondent and controls and directs the business activities, sales policies and practices of the corporate respondent. The respondents have acted in conjunction and cooperation with each other in carrying out the acts and practices hereinafter described. Respondents are now and for more than three years last past have been engaged in the manufacture of devices commonly known as push cards and punch boards, and in the sale and distribution of said devices to manufacturers of, and dealers in, various articles of merchandise in commerce between

and among the various States of the United States, and in the District of Columbia.

Respondents cause and have caused said devices, when sold, to be transported from their place of business in the State of New York to purchasers thereof at their points of location in the various States of the United States other than New York, and in the District of Columbia. There is now and has been for more than three years last past a course of trade in such devices by said respondents in commerce between and among the various States of the United States and in the District of Columbia.

Paragraph Two: In the course and conduct of their said business as described in Paragraph One hereof, respondents sell and distribute, and have sold and distributed, to said manufacturers of and dealers in merchandise, push cards and punch boards so prepared and arranged as to involve games of chance, gift enterprises or lottery schemes when used in making sales of merchandise to the consuming public. Respondents sell and distribute, and have sold and distributed many kinds of push cards and punch boards, but all of said devices involve the same chance or lottery features when used in connection with the sale or distribution of merchandise and vary only in detail.

Many of said push cards and punch boards have printed on the faces thereof certain legends or instructions that explain the manner in which said devices are to be used or may be used in the sale or distribution of various specified articles of merchandise. The prices of the sales on said push cards and

punch boards vary in accordance with the individual device. Each purchaser is entitled to one punch or push from the push card or punch board, and when a push or punch is made a disc or printed slip is separated from the push card or punch board and a number is disclosed. The numbers are effectively concealed from the purchasers and prospective purchasers until a selection has been made and the push or punch completed. Certain specified numbers entitle purchasers to designated articles of merchandise. Persons securing lucky or winning numbers receive articles of merchandise without additional cost at prices which are much less that the normal retail price of said articles of merchandise. Persons who do not secure such lucky or winning numbers receive nothing for their money other than the privilege of making a push or punch from said card or board. The articles of merchandise are thus distributed to the consuming or purchasing public wholly by lot or chance.

Others of said push card and punch board devices have no instructions or legends thereon but have blank spaces provided therefor. On those push cards and punch boards the purchasers thereof place instructions or legends which have the same import and meaning as the instructions or legends placed by the respondents on said push card and punch board devices first hereinabove described. The only use to be made of said push card and punch board devices, and the only manner in which they are used, by the ultimate purchasers thereof, is in combination with other merchandise so as to enable said

ultimate purchasers to sell or distribute said other merchandise by means of lot or chance as hereinabove described.

Paragraph Three: Many persons, firms and corporations who sell and distribute, and have sold and distributed, candy, cigarettes, clocks, razors, cosmetics, clothing, and other articles of merchandise in commerce between and among the various States of the United States and in the District of Columbia, purchase and have purchased respondents' said push card and punch board devices, and pack and assemble and have packed and assembled, assortments comprised of various articles of merchandise together with said push cards and punch board devices. Retail dealers who have purchased said assortments either directly or indirectly have exposed the same to the purchasing public and have sold or distributed said articles of merchandise by means of said push cards and punch boards in accordance with the sales plan as described in Paragraph Two hereof. Because of the element of chance involved in connection with the sale and distribution of said merchandise by means of said push cards and punch boards, many members of the purchasing public have been induced to trade or deal with retail dealers selling or distributing said merchandise by means thereof. As a result thereof many retail dealers have been induced to deal with or trade with manufacturers, wholesale dealers and jobbers who sell and distribute said merchandise together with said devices.

Paragraph Four: The sale of merchandise to the purchasing public through the use of, or by means of, such devices in the manner above described, involves a game of chance or the sale of a chance to procure articles of merchandise at prices much less than the normal retail price thereof and teaches and encourages gambling among members of the public, all to the injury of the public. The use of said sales plan or methods in the sale of merchandise and the sale of merchandise by and through the use thereof, and by the aid of said sales plan or method is a practice which is contrary to an established public policy of the Government of the United States and in violation of criminal laws, and constitutes unfair acts and practices in said commerce.

The sale or distribution of said push cards and punch board devices by respondents as described herein supplies to and places in the hands of others the means of conducting lotteries, games of chance or gift enterprises in the sale or distribution of their merchandise. The respondents thus supply to, and place in the hands of, said persons, firms and corporations the means of, and instrumentalities for, engaging in unfair acts and practices within the intent and meaning of the Federal Trade Commission Act.

Conclusion

The aforesaid acts and practices of respondents as herein found are all to the prejudice and injury of the public and constitute unfair acts and prac-

tices in commerce within the intent and meaning of the Federal Trade Commission Act.

By the Commission.

/s/ JAS. M. MEAD,
Chairman.

Issued: October 24, 1950.

Attest:

/s/ D. C. DANIEL,
Secretary.

United States of America
Before Federal Trade Commission

Docket No. 5525

Commissioners: Jame M. Mead, Chairman
William A. Ayers
Lowell B. Mason
John Carson

In the Matter of

BORK MANUFACTURING CO., INC., a Corporation, and ALVIN BORKIN, and Individual and President of Bork Manufacturing Co., Inc.

ORDER TO CEASE AND DESIST

This proceeding having been heard by the Federal Trade Commission upon the complaint of the Commission and the substitute answer of respondents, in which answer respondents admitted all the

material allegations of fact set forth in the complaint and reserved the right of filing brief before the Commission, which right, however, has not been exercised by respondents; and the Commission having made its findings as to the facts and its conclusion that the respondents have violated the provisions of the Federal Trade Commission Act:

It Is Ordered that respondent Bork Manufacturing Co., Inc., a corporation, and its officers, agents, representatives, and employees, and respondent Alvin Borkin, individually and as an officer of said corporation, and his agents, representatives, and employees, directly or through any corporate or other device, do forthwith cease and desist from:

> Selling or distributing in commerce, as "commerce" is defined in the Federal Trade Commission Act, punch boards, push cards, or other lottery devices which are to be used or may be used in the sale or distribution of merchandise to the public by means of a game of chance, gift enterprise, or lottery scheme.

It Is Further Ordered that the respondent shall, within sixty (60) days after service upon them of this order, file with the Commission a report in writing, setting forth in detail the manner and form in which they have complied with this order.

By the Commission, Commissioner Mason concurring in the findings as to the facts and conclusion, but not concurring in the form of order to cease and desist, for the reasons stated in his opinion concur-

ring in part and dissenting in part in Docket 5203—Worthmore Sales Company.

[Seal] /s/ D. C. DANIEL,
Secretary.

Initialed: J. W. M.
L. B. M.
W. A. A.

Issued: October 24, 1950.

Certificate

This is to certify that the following pages and related exhibits are a transcript of hearings before the Federal Trade Commission in the matter of:

Docket No.: 5525
Case Title: Bork Manufacturing Co., Inc., a corporation, and Alvin Borkin, an individual and president of Bork Manufacturing Co., Inc.
Place: New York, N. Y.
Date: September 23, 1948.
Pages Numbered: 1 to 5, inclusive.

which were had as therein appears, and that this is the original transcript thereof for the files of the Commission.

ALDERSON REPORTING COMPANY,
Official Reporters.

By /s/ FRANK McCABE,
Partner.

Before the Federal Trade Commission
Docket No. 5525

In the Matter of

BORK MANUFACTURING CO., INC., a Corporation, and ALVIN BORKIN, an Individual and President of Bork Manufacturing Co., Inc.

September 23,1948.

Met, pursuant to notice, at 10:00 a.m.

Before: W. W. Sheppard, Trial Examiner.

Appearances:

JOHN W. BROOKFIELD, JR.,
Attorney supporting the complaint.

MAXWELL SLOTE,
Attorney for the Bork Manufacturing Co.

PROCEEDINGS

Trial Examiner Sheppard: Come to order, gentlemen.

We will convene the hearing ordered by the Federal Trade Commission in the matter of the Bork Manufacturing Company, Incorporated, a corporation, and Alvin Borkin, an individual and president of the Bork Manufacturing Company, Incorporated, Docket No. 5525, which is convened in Room 500, 45 Broadway, the Commission's office in New York City, at 10 o'clock a.m. this day, the 23rd of September, 1948.

Let the record show that Mr. John W. Brookfield, Jr., attorney of the Federal Trade Commission, is

supporting the complaint in this case; and Mr. Maxwell Slote is the attorney in charge of the respondents' case. His address is 350 Fifth Avenue, New York City.

Now, gentlemen, Mr. Brookfield, of course, knows my procedure in the cases, but Mr. Slote does not. I always like to give an opportunity for counsel to get together as far as possible in all these cases before we go to trial. I understand that in this case there has been some preliminary talk and agreements. Mr. Brookfield, I am ready now to hear what you have before you.

Mr. Brookfield: If your Honor please, Mr. Slote and I conferred at great length yesterday, and we have arrived at an agreement wherein he is submitting an admission answer and a motion to withdraw the answer previously followed; and also a letter to the Commission submitting the terms under which the admission answer is to be filed, the terms being that no order is to be entered in this case against these respondents prior to the decision of the Commission in the Harlich Manufacturing Company case, Docket No. 4859. That, I am informed by my superiors, will be recommended as acceptable to the Commission, as we have done it in several other cases.

Trial Examiner Sheppard: That has been done before, has it?

Mr. Brookfield: Yes.

Trial Examiner Sheppard: You know I am not familiar with what——

Mr. Brookfield (Interposing): I have several

cases in my files right now where similar admission answers have been filed under an agreement that they be not considered by the Commission prior to consideration of the Harlich case; in other words, the purpose being that these people do not want to be put at a disadvantage while the Harlich case is still pending.

Trial Examiner Sheppard: I see.

Mr. Brookfield: Under those circumstances, I ask that this hearing be adjourned. Upon receipt of the admission answer by the Commission, I will notify you and you may close your proceedings.

Trial Examiner Sheppard: Mr. Slote, you have heard Mr. Brookfield's statement. Is that satisfactory to you?

Mr. Slote: Yes, the statement by Mr. Brookfield is accurate and in accordance with our understanding.

Trial Examiner Sheppard: Well, very well, then, gentlemen, I am going to recess this case so as to give the Commission an opportunity to act; and if the Commission does act in accordance with what Mr. Brookfield says, and to which Mr. Slote agrees, there will not be any necessity for any further action in this case.

However, if the Commission does not, of course it will be my duty and Mr. Brookfield's duty to proceed, and you may ask me for another date.

Mr. Brookfield: May I make a further statement?

Trial Examiner Sheppard: Yes.

Mr. Brookfield: I am cognizant, sir, of the fact

that you are authorized to permit the filing of a substitute answer; but in view of the fact that we have this condition attached to it, I did not submit it to you, because I thought you were passing that on to the Commission instead of ruling on it yourself.

Trial Examiner Sheppard: That is right, exactly.

Mr. Brookfield: I would also like the record to show that the subpoenas issued for Mr. Borkin and subpoena duces tecum issued for Mr. Jacobs of the Bork Manufacturing Company, they are discharged therefrom, in view of the fact that we have settled the case.

Trial Examiner Sheppard: That is right, and they can be renewed if the case is renewed.

Mr. Brookfield: Yes.

Trial Examiner Sheppard: In view of the circumstances as stated here, the Examiner will recess this hearing, or rather, adjourn it until the Commission has acted or until I hear from Mr. Brookfield.

We stand adjourned in New York City this date.

(Whereupon, at 10:15 a.m., September 23, 1948, the hearing in the above-entitled matter was adjourned.)

CERTIFICATE OF SECRETARY

Before Federal Trade Commission.

I, D. C. Daniel, Secretary of the Federal Trade Commission and official custodian of its records, do hereby certify that transmitted herewith is a full, true, and complete transcript of proceedings had before the Federal Trade Commission in the above-entitled matter.

That this transcript is certified to the United States Court of Appeals for the Ninth Circuit, pursuant to the filing in said Court of a petition for review of an Order to Cease and Desist dated October 24, 1950, issued by the Federal Trade Commission in the above-indicated proceeding.

In witness whereof, I hereunto subscribe my name, and affix the seal of the said Federal Trade Commission, at its office in the City of Washington, D. C., this 5th day of February, A.D. 1951.

[Seal] /s/ D. C. DANIEL,
Secretary.

[Endorsed]: No. 12796. United States Court of Appeals for the Ninth Circuit. Bork Manufacturing Co., Inc., a Corporation, and Alvin Borkin, an Individual and President of Bork Manufacturing Co., Inc., Petitioners, vs. Federal Trade Commission, Respondent. Transcript of the Record. Petition to Review an Order of the Federal Trade Commission.

Filed February 7, 1951.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 12796

BORK MANUFACTURING CO., INC., a Corporation, and ALVIN BORKIN, an Individual and President of Bork Manufacturing Co., Inc.,
Petitioner,

vs.

FEDERAL TRADE COMMISSION,
Respondent.

PETITION TO REVIEW AN ORDER OF THE FEDERAL TRADE COMMISSION

To the Honorable, Judges of the United States Court of Appeals for the Ninth Circuit:

Your petitioner, Bork Manufacturing Co., Inc., a corporation organized and doing business under and by virtue of the laws of the State of New York, with its principal office and place of business located at 719 Broadway, New York City, New York, respectfully represents:

I. That your petitioner was on January 9, 1948, a corporation organized under the laws of the State of New York.

II. That on January 9, 1948, the Federal Trade Commission caused its complaint (Docket No. 5525) to be issued against your petitioner attempting to allege the use of unfair methods of competition, unfair acts and practices in interstate commerce in

violation of the provisions of Section 5 of an Act of Congress approved September 26, 1914, as amended March 21, 1938, entitled "An Act to create a Federal Trade Commission, to define its powers and duties, and for other purposes." The answer of your petitioner to said complaint was filed thereafter in said proceeding admitting all of the facts alleged in said complaint.

III. That thereafter, November 2, 1950, the Federal Trade Commission served its report and its purported findings as to the facts and conclusion of law and its purported order to cease and desist against your petitioner, which order is in substance as follows:

"It is ordered that the respondent, Bork Manufacturing Co., Inc., or trading under any other name or trading designation, and said respondent's agents, representatives and employees, directly or through any corporate or other device, do forthwith cease and desist from:

> "Selling or distributing in commerce, as commerce is defined in the Federal Trade Commission Act, punchboards, push cards, or other lottery devices, which are to be used, or may be used, in the sale or distribution of merchandise to the public by means of a game of chance, gift enterprise or lottery scheme."

IV. That the method of competition and the acts and practices in question and proceeded against were used by your petitioner throughout the United States, including the states of Washington, Oregon

and California, in the circuit of and within the jurisdiction of the United States Court of Appeals for the Ninth Circuit.

V. Your petitioner, believing itself aggrieved by said cease and desist order of the respondent and considering it unauthorized, erroneous, void, and unlawfully prejudicial to your petitioner, and your petitioner being without remedy in the premises except in this court as by statute in such cases made and provided, hereby petitions for a review of said order of the commission by this Honorable Court.

Wherefore, your petitioner prays that this Honorable Court exercise its jurisdiction over the parties and subject matter of this petition, and that the order of the commission be set aside.

Your petitioner further prays that this Honorable Court review the findings and order of the Federal Trade Commission in said cause and enter a decree in this Honorable Court setting aside the said order of the Federal Trade Commission against your petitioner and that such other and further orders and decrees be made as to the Court may seem just.

/s/ F. W. JAMES,

/s/ GEO. E. LINDELOF, JR.,
Attorneys for Petitioner.

State of Illinois,
County of Cook—ss.

F. W. James, being first duly sworn on oath, deposes and says that he is an attorney for peti-

tioner; that he has read the above and foregoing petition by him subscribed and knows the contents thereof, and that the same is true in substance and in fact except as to those allegations alleged on belief, and as to those he verily believes them to be true; that he subscribed said petition in his capacity as attorney for the petitioner, Bork Manufacturing Co., Inc., being thereunto duly authorized.

/s/ F. W. JAMES.

Subscribed and sworn to before me this the 26th day of December, 1950.

[Seal] /s/ NICOLAS JOHN MOLITOR,
Notary Public.

My Commission expires March 15, 1951.

[Endorsed]: Filed December 27, 1950.

[Title of Court of Appeals and Cause.]

STATEMENT OF POINTS

Comes now the petitioners above named and file their statement of points on which they intend to rely:

1. The facts alleged by the Commission in its complaint on file herein are not sufficient to give the Commission jurisdiction to issue a cease and desist order against petitioners.

2. The acts and practices of petitioners are not a violation of the Federal Trade Commission Act.

3. The findings of fact are not sufficient to support the order.

4. The proceeding is not to the interest of the public as required by the F. T. C. Act.

5. The findings of fact and the order are broader than the complaint.

6. The order is too broad.

7. The order entered herein is contrary to and against law.

8. The facts alleged in the complaint are not sufficient to support the order entered herein.

Respectfully submitted,

/s/ F. W. JAMES,
Attorney for Petitioners.

[Endorsed]: Filed February 26, 1951.

No. 12796

United States Court of Appeals

FOR THE NINTH CIRCUIT

BORK MANUFACTURING CO., INC., a Corporation, and ALVIN BORKIN, an Individual and President of Bork Manufacturing Co., Inc.,

Petitioners,

vs.

FEDERAL TRADE COMMISSION,

Respondent.

Brief and Argument for Petitioners

PETITION TO REVIEW AN ORDER OF THE FEDERAL TRADE COMMISSION

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PAUL P. O'BRIEN

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United States Court of Appeals

FOR THE NINTH CIRCUIT

No. 12796

BORK MANUFACTURING CO., INC., a Corporation, and ALVIN BORKIN, an Individual and President of Bork Manufacturing Co., Inc., PETITIONERS,

vs.

FEDERAL TRADE COMMISSION, RESPONDENT.

PETITION TO REVIEW AN ORDER OF THE FEDERAL TRADE COMMISSION

STATEMENT OF THE FACTS

This case comes before the court on a petition to review a cease and desist order issued against petitioners by the Federal Trade Commission. Sec. 5 of the Federal Trade Commission Act, 52 Stat. Ill., 15 U.S.C.A. Sec. 45, provides for review of the orders of the Federal Trade Commission by the United States Circuit Court of Appeals.

Alvin Borkin did not join in the petition to review.

FINDINGS AS TO THE FACTS AND CONCLUSION

The facts set out in the findings are sufficient to give the court a full understanding of the issues involved. The findings are as follows:

FINDINGS AS TO THE FACTS

Paragraph One: Petitioner, Bork Manufacturing Co., Inc., is a corporation organized and doing business under and

by virtue of the laws of the State of New York, with its principal office and place of business located at 6201 15th Avenue, in the city of Brooklyn, New York. Petitioner, Alvin Borkin, is an individual, and president of said corporate petitioner and controls and directs the business activities, sales policies and practices of the corporate petitioner. The petitioners have acted in conjunction and cooperation with each other in carrying out the acts and practices hereinafter described. Petitioners are now and for more than three years last past have been engaged in the manufacture of devices commonly known as push cards and punch boards, and in the sale and distribution of said devices to manufacturers of, and dealers in, various articles of merchandise in commerce between and among the various States of the United States, and in the District of Columbia.

Petitioners cause and have caused said devices, when sold, to be transported from their place of business in the State of New York to purchasers thereof at their points of location in the various States of the United States other than New York, and in the District of Columbia. There is now and has been for more than three years last past a course of trade in such devices by said petitioners in commerce between and among the various States of the United States and in the District of Columbia.

Paragraph Two: In the course and conduct of their said business as described in Paragraph One hereof, petitioners sell and distribute, and have sold and distributed, to said manufacturers of and dealers in merchandise, push cards and punch boards so prepared and arranged as to involve games of chance, gift enterprises or lottery schemes when used in making sales of merchandise to the consuming public. Petitioners sell and distribute many kinds of push cards and punch boards, but all of said devices involve the same chance or lottery features when used in connection with the sale or distribution of merchandise and vary only in detail.

Many of said push cards and punch boards have printed

on the faces thereof certain legends or instructions that explain the manner in which said devices are to be used or may be used in the sale or distribution of various specific articles of merchandise. The prices of the sales on said push cards and punch boards vary in accordance with the individual device. Each purchaser is entitled to one punch or push from the push card or punch board, and when a push or punch is made a disc or printed slip is separated from the push card or punch board and a number is disclosed. The numbers are effectively concealed from the purchasers and prospective purchasers until a selection has been made and the push or punch completed. Certain specified numbers entitle purchasers to designated articles of merchandise. Persons securing lucky or winning numbers receive articles of merchandise without additional cost at prices which are much less than the normal retail price of said articles of merchandise. Persons who do not secure such lucky or winning numbers receive nothing for their money other than the privilege of making a push or punch from said card or board. The articles of merchandise are thus distributed to the consuming or purchasing public wholly by lot or chance.

Others of said push card and punch board devices have no instructions or legends thereon but have blank spaces provided therefor. On those push cards and punch boards the purchasers thereof place instructions or legends which have the same import and meaning as the instructions or legends placed by the petitioners on said push card and punch board devices first hereinabove described. The only use to be made of said push card and punch board devices, and the only manner in which they are used, by the ultimate purchasers thereof, is in combination with other merchandise so as to enable said ultimate purchaser to sell or distribute said other merchandise by means of lot or chance as hereinabove described.

Paragraph Three: Many persons, firms and corporations who sell and distribute, and have sold and distributed,

candy, cigarettes, clocks, razors, cosmetics, clothing, and other articles of merchandise in commerce between and among the various States of the United States and in the District of Columbia, purchase and have purchased petitioners' said push card and punch board devices, and pack and assemble and have packed and assembled, assortments comprised of various articles of merchandise together with said push cards and punch board devices. Retail dealers who have purchased said assortments either directly or indirectly have exposed the same to the purchasing public and have sold or distributed said articles of merchandise by means of said push cards and punch boards in accordance with the sales plan as described in Paragraph Two hereof. Because of the element of chance involved in connection with the sale and distribution of said merchandise by means of said push cards and punch boards, many members of the purchasing public have been induced to trade or deal with retail dealers selling or distributing said merchandise by means thereof. As a result thereof many retail dealers have been induced to deal with or trade with manufacturers, wholesale dealers and jobbers who sell and distribute said merchandise together with said devices.

Paragraph Four: The sale of merchandise to the purchasing public through the use of, or by means of, such devices in the manner above described, involves a game of chance or the sale of a chance to procure articles of merchandise at prices much less than the normal retail price thereof and teaches and encourages gambling among members of the public, all to the injury of the public. The use of said sales plan or methods in the sale of merchandise by and through the use thereof, and by the aid of said sales plan or method is a practice which is contrary to an established public policy of the Government of the United States and in violation of criminal laws, and constitutes unfair acts and practices in said commerce.

The sale or distribution of said push cards and punch board devices by petitioners as described herein supplies to

and places in the hands of others the means of conducting lotteries, games of chance or gift enterprises in the sale or distribution of their merchandise. The petitioners thus supply to, and place in the hands of, said persons, firms and corporations the means of, and instrumentalities for, engaging in unfair acts and practices within the intent and meaning of the Federal Trade Commission Act.

ORDER TO CEASE AND DESIST

It Is Ordered that petitioner Bork Manufactuirng Co., Inc., a corporation, and its officers, agents, representatives, and employees, and petitioner Alvin Borkin, individually and as an officer of said corporation, and his agents, representatives, and employees, directly or through any corporate or other device, do forthwith cease and desist from:

> Selling or distributing in commerce, as "commerce" is defined in the Federal Trade Commission Act, punch boards, push cards, or other lottery devices which are to be used or may be used in the sale or distribution of merchandise to the public by means of a game of chance, gift enterprise, or lottery scheme.

By the Commission, Commissioner Mason concurring in the findings as to the facts and conclusion, but not concurring in the form of order to cease and desist, for the reasons stated in his opinion concurring in part and dissenting in part in Docket 5203—Worthmore Sales Company.

STATUTORY PROVISIONS UNDER WHICH THESE PROCEEDINGS ARE PROSECUTED

The petition filed in this Court alleges that petitioners do business within the jurisdiction of this Court.

The Federal Trade Commission Act provides in part as follows:

"Sec. 5. UNFAIR METHODS OF COMPETITION OR DECEPTIVE ACTS OR PRACTICES. COMPLAINTS, FINDINGS, AND ORDERS OF COMMISSION. APPEALS. SERVICE. PENALTIES. (52 Stat. 111; 15 U.S.C.A., sec. 45.)

"Sec. 5. (a) Unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are hereby declared unlawful.

"The Commission is hereby empowered and directed to prevent persons, partnerships, or corporations, except banks, common carriers, subject to the Acts to regulate commerce, air carriers and foreign air carriers subject to the Civil Aeronautics Act of 1938,[3] and persons, partnerships, or corporations subject to the Packers and Stockyards Act, 1921, except as provided in section 406 (b) of said Act, from using unfair methods of competition in commerce and unfair or deceptive acts or practices in commerce.

"(b) Whenever the Commission shall have reason to believe that any such person, partnership, or corporation has been or is using any unfair methods of competition or unfair or deceptive act or practice in commerce, and if it shall appear to the Commission that a proceeding by it in respect thereof would be to the interest of the public, it shall issue and serve upon such person, partnership, or corporation a complaint stating its charges in that respect and containing a notice of a hearing upon a day and at a place therein fixed at least thirty days after the service of said complaint. The person, partnership, or corporation so complained of shall have the right to appear at the place and time so fixed and show cause why an order should not be entered by the Commission requiring such person, partnership, or corporation to cease and desist from the violation of the law so charged in said complaint.

"(c) Any person, partnership, or corporation required by an order of the Commission to cease and desist from using any method of competition or act or practice may obtain a review of such order in the circuit court of appeals of the United States, within any circuit where the method of competition or the act or practice in question was used or where such person, partnership, or corporation resides or carries on business, by filing in the court, within sixty days' from the date of the service of such order, a written petition praying that the order of the Commission be set aside. A copy of such petition shall be forthwith served upon the Commission, and thereupon the Commission forthwith shall certify and file in the court a transcript of the entire record in the proceeding, including all the evidence taken and the report and order of the Commission. Upon such filing of the petition and transcript the court shall have jurisdiction of the proceeding and of the question determined therein, and shall have power to make and enter upon the pleadings, evidence, and proceedings set forth in such transcript a decree affirming, modifying, or setting aside the order of the Commission, and enforcing the same to the extent that such order is affirmed."

STATEMENT OF THE CASE

The only question presented herein is, does the Federal Trade Commission have jurisdiction to restrain petitioners from shipping punch boards in interstate commerce which are to be used or may be used to distribute merchandise.

ASSIGNMENT OF ERRORS

I.

The Federal Trade Commission does not have jurisdiction to restrain Petitioners from shipping punch boards in interstate commerce.

II.

The order issued herein is contrary to and against law.

ARGUMENT

THE RULE OF STRICT CONSTRUCTION MUST BE APPLIED TO THE FEDERAL TRADE COMMISSION ACT.

The Federal Trade Commission being a statutory creation, the basic and underlying problem throughout the entire consideration of this case is one of statutory construction. When a court is confronted with the duty of constructing a statute, the first question to be resolved is whether the enactment in question is of the type that is to be strictly construed. The United States Supreme Court has answered this question as to the enactment involved herein in at least three cases; *Federal Trade Commission vs. Bunte Bros.,* 312 U. S. 349, *Federal Trade Commission vs. Raladam Co.,* 283 U. S. 643, and the *Federal Trade Commission v. Klesner,* 280 U.S. 19. In each of these cases it was held that the Federal Trade Commission Act is within the rule of strict construction, in fact the very strictest construction must be applied. The Supreme Court in the *Klesner* case, *supra,* said:

> "* * * the scope of its authority is strictly limited."

This brief statement is made for two purposes: first, to establish at the outset that by law as laid down by the Supreme Court the Federal Trade Commission Act is controlled, comes within, and is governed by the rule of law which is known as the rule of strict construction, second, that at all times hereinafter this principle of construction should be constantly born in mind and applied during the entire deliberation of this case.

UNDER WHAT PRINCIPLE OF LAW IS THE COMMISSION PROCEEDING.

In the face of the Supreme Court's holding in the *Bunte* case, *infra,* it is impossible for the petitioner to determine or comprehend the theory upon which the commission relies to sustain its jurisdiction to issue such a broad and all inclusive cease and desist order as has been issued by it herein.

To present to the court the reason why petitioner is in the above dilemma it is necessary to first point out the holding in the *Brewer* case, *supra;* second, to point out the theory found in the finding of facts; third, to point out the all inclusiveness of the order and, finally, to discuss a portion of the Federal Trade Commission Act.

The Supreme Court in the *Bunte* case, *supra,* held that intrastate transactions are not within the jurisdiction of the Federal Trade Commission Act. In other words, only transactions in interstate commerce are within the purview of the Commission's jurisdiction.

This holding is very vital because the petitioner ships punch boards to people who use them exclusively in intrastate commerce to distribute merchandise.

In its findings, the Commission relies upon the theory that:

> "Petitioner supplies to, and places in the hands of persons, firms and corporations the means of, and instrumentalities for, engaging in unfair acts and practices within the intent and meaning of the Federal Trade Commission Act." (Rec. 22).

This establishes beyond doubt that the only theory upon which the Commission is relying to sustain its jurisdiction is that "one who furnishes or supplies the means of and instrumentalities for, engaging in unfair cuts and practices which are within the corrective power of the commission is himself violating the act."

Under this theory, as the intrastate use of punch boards to distribute merchandise is not within the purview of the Federal Trade Commission Act, the Commission does not have power to restrain the petitioner from shipping punch boards to people who use them exclusively in intrastate transactions, even though the punch boards are used to distribute merchandise. To illustrate: a tavern located in a different state buys punch boards from the petitioner. The petitioner ships the boards in interstate commerce to the tavern and the tavern uses the punch boards to distribute merchandise. In so doing the tavern is not violating the Federal Trade Commission Act. Therefore, under the principle of law set out in the findings the Commission has no power to restrain the petitioners from shipping or distributing punch boards to the tavern nor to other places under like circumstances.

Notwithstanding this, the order restrains the petitioners from shipping punch boards to people who use them to distribute merchandise in a manner which is not within the purview of the act.

From this it is obvious that the order to cease and desist is much broader than the Commission's theory. For this reason the theory as set out in the findings, even if the theory were sound which the petitioner contends is not so, does not sustain the issuing of such an all inclusive order.

The order is as follows:

> "* * * do forthwith cease and desist from: Selling or distribution in commerce, as "Commerce" is defined in the Federal Trade Commission Act, punch boards, push cards, or other lottery devices which are to be used or may be used in the sale or distribution of merchandise to the public by means of a game of chance, gift enterprise, or lottery scheme."

This order prohibits the petitioners from shipping to people who are going to use them to distribute merchandise regard-

less of whether or not the distribution of the merchandise by the boards is in violation of the Federal Trade Commission Act. Again we say, the order is much broader than the theory set out in the findings and is contrary to the holding in the *Bunte,* case, *supra.* That is to say, that the order cannot be sustained on the theory set out in the findings in the face of the holding in the *Bunte* case.

To be within the theory set out in the findings the order would have to read somewhat like this:

> "Petitioner must forthwith cease and desist from: Selling or distributing in commerce, as "Commerce" is defined in the Federal Trade Commission Act, punch boards, push cards, which are to be used to engage in unfair acts and practices within the intent and meaning of the Federal Trade Commission Act."

From the above it is self-evident why the petitioner cannot comprehend what theory or principle of law the Commission is relying upon to sustain its jurisdiction to issue such a broad and all inclusive order.

The following discussion of the Federal Trade Commission Act will show why the petitioner is unable to determine from the act itself what theory the Commission is proceeding upon.

The act provides in part as follows to-wit:

> "Unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce are hereby declared unlawful."

The question under this portion of the act is: Are the acts complained of herein (1) unfair methods of competition, (2) deceptive acts or practices, (3) unfair acts or practices?

The Supreme Court in the case of *Federal Trade Commision vs. Raladam Co.,* 283 U. S. 643; 51 Sup. Ct. 335, held

that injury to competitors is an essential and indispensible element in characterizing any method, act or practice as an "unfair method of competition." Therefore, as the Commission admits that the petitioners' acts and practices do not in any shape or form directly or indirectly injure their competitor it is obvious that petitioners' conduct is not an unfair method of competition.

Petitioners' acts are not within the second category because the commission makes no claim that they are deceptive.

The remaining question under this portion of the act is, are the acts and practices of petitioners unfair within the meaning of that word as it is used in the Federal Trade Commission Act?

If there is to be any consistency in the interpretation of the word "unfair" as Congress used this word in the statute creating the Federal Trade Commission there must be some criterion established to guide courts in their application of this word, "unfair," to the different and various methods, acts and practices which they are called upon to either include or exclude from the corrective power of the Commission.

The very nature of the Federal Trade Commission Act requires that the criterion to be adopted must limit the meaning of the word "unfair" to methods, acts and practices which are either unfair to "competitors," "purchasers," or both. The Federal Trade Commission is certainly a *trade* commission; therefore, its functions should and must be confined strictly within the limits of trade, that is to "unfair *trade* practices, acts, or methods." Practices, acts, or methods which may be unfair in other respects cannot be brought within the corrective jurisdiction of the Federal Trade Commission. Therefore, among other elements, this criterion should limit the meaning of the word "unfair" as the word is used in the Federal Trade Commission Act to methods, acts or practices which are either unfair to "competitors" or unfair to "purchasers" or both. Reason and logic compel the insertion in the criterion of such a standard.

The testimony of the last Commissioner Davis given before the House Committee at the time the Commission was advocating the adoption of the Wheeler Lea Amendment substantiates the above contentions. He testified in part as follows:

> (Hearings on H.R. 3143, 75th Cong., 1st Sess. pp. 6, 9, and 14:) Commissioner Davis
>
> "We say, Congressman Chapman, that there is no distinction between an unfair *trade* pratice or an unfair or deceptive act; but it is the words 'method of competition' that they play upon all the time—that we must prove that there is competition." (Italics provided).
>
> "* * * For instance, why does a man engage in an unfair practice? He does it in order to get business; in order to deceive the public and induce sales; in order to get an advantage over his competitors."
>
> * * * * *
>
> "People engaged in trade deal with the consuming public, and whenever they engage in unfair or deceptive practice, then it is not only unfair to their competitors, but it is unfair to the public, either way you put it, and if it is unfair to the public, *if it decives the public and induces the public to trade* with them when they would not do it in the absence of those *false representations,* or *unfair trade practices,* it is inevitable that it is also unfair to competitors." (Italics provided).

Commissioner Davis' above quoted statements show that the sole object of the 1938 Amendment, instigated by the Commission, was to reach, *without proving the element of competition,* those cases wherein a merchant or trader was seeking to secure orders for his products in interstate com-

merce by using "unfair" or "deceptive" "acts" or "practices." The sole object of the amendment was to make it possible to reach cases of this type by proving through substantial evidence that the respondent sought or received orders through the medium of interstate commercial acts or practices which are unfair or deceptive to purchasers or prospective purchasers of things marketed, or sought to be marketed, by the merchant or trader in interstate commerce.

In the case of *Pep Boys—Manny, Moe, and Jack, Inc., vs. Federal Trade Commission,* 122 F. (2) 158, the court substantiates petitioners contention that the word "unfair" is confined to such practices which are either unfair to consumers or competitors. On this point the court said:

> "The failure to mention competition in the later phrase shows a legislative intent to remove the procedural requirement set up in the *Raladam* case and the Commission can now center its attention on the *direct protection of the consumer* where formerly it could protect him only indirectly through the protection of the competitor." (Italics provided).

By the standards of such a criterion petitioners' methods, acts, and practices are eliminated from the purview of the Federal Trade Commission's corrective action because, as has been said before, petitioners' acts and practices complained of herein are not, and the Commission makes no claim that they are, unfair to petitioners' competitors or unfair to petitioners' purchasers or purchasers of petitioner products. Lacking these two essential and indispensible elements, the petitioners' acts and practices are not unfair within the meaning and intent of the Federal Trade Commission Act. In other words, if any act or practice is not unfair either to competitors or to purchasers of petitioners' merchandise, the complained of methods, acts, or practices should not be held to be unfair within the intent and meaning of the Federal Trade Commission Act. As the petitioners' acts according to the

above discussion are not unfair within the meaning and intent of the Federal Trade Commission Act, the petitioner cannot comprehend, upon what theory or principle of law the commission relies in determining what acts are or are not within the Commission's corrective jurisdiction.

It should be noted that by the follwing portion of section 5 of the act:

> "The Commission is hereby empowered and directed to prevent persons, partnerships, or corporations, * * * from *using* unfair methods or competition in commerce and unfair or deceptive acts or practices in commerce." (Italics provided).

Congress expressly limited, confined, and cirmumscribed the Commission's power to the field and activity of *using* unfair acts and practices or unfair methods of competition in commerce. The *using* of an act, practice, or method means that the act, practice, or method complained of is used as a means to an end and is not the end itself. The Commission makes no contention that the petitioners are *using* any acts, methods or practices.

If the word "in" as used in the Federal Trade Commission Act means only "in" and not "Affecting" the word "using" as it appears in the same act must not be construed to mean "placing in the hands of others." The word "using" has its limited meaning the same as the word "in" has its limited meaning.

As this court in the case of *California Rice Industries vs. Federal Trade Commission* 102 F (2) 716 and the Supreme Court in the case of *Bunte Bros.,* 312 U.S. 349, said "in" can not be construed as including, "affecting." This Court and the Supreme Court, to be consistent, must adopt the same strictness in construing the word *"using"* as they did in construing the word "in."

Petitioners have shown that the complained of acts herein are not unfair methods, acts, or practices within the intent

and meaning of the Federal Trade Commission Act; also, the petitioners have established that the said methods, acts, or practices are not being used by petitioners.

The Commission in this proceeding is asking the court to read into the Federal Trade Commission Act words and meanings that are not there and which were never intended to be there. This, the Supreme Court in the *Bunte* case, and this Court in the case of *California Rice Industries, supra,* said cannot be done.

It should be apparent that petitioners do *not* in any way "*use*" (as distinguished from "aiding and abetting, inducing and procuring") unfair methods of competition in commerce and unfair or deceptive acts in commerce either to their competitors or the purchasing public. Likewise, in no way do petitioners "furnish another with the means of consummating a fraud," and, as has been pointed out, the complained of acts of petitioners do not give petitioners any unfair advantage over their competitors nor do they cast upon their competitors the burden of the loss of business unless they will descend to a practice which they are under a powerful moral compulsion not to adopt. Therefore, it would seem that none of these complained of acts come within the corrective power of the Federal Trade Commission as the Petitioners have shown that (1) petitioners' acts are not unfair methods of competition; (2) they are not deceptive; (3) they are not unfair; (4) petitioners are not *using* any methods, acts or practices, it is obvious that the petitioner does not know upon what principle of law the commission is relying upon.

THE CASE OF SCIENTIFIC MANUFACTURING COMPANY, INC.

In *Scientific Manufacturing Company, Inc. vs. Federal Trade Commission,* 124 F. (2) 640, the United States Circuit Court of Appeals for the third Circuit decided all of the issues raised in the case at bar in favor of the petitioners and against the Commission.

In that case the complaint issued by the Commission, Docket No. 3874, (32 Federal Trade Commission Decisions 493) (1941) alleged that Scientific Manufacturing Company, Inc., sold and distributed pamphlets principally through manufacturers of cooking utensils who were engaged in competition in commerce with manufacturers of aluminum ware. These pamphlets contained false and derogatory utterances concerning the use of aluminum in cooking utensils. The Commission charged that the act and practices of Scientific Manufacturing Company, Inc., constituted unfair methods of competition and unfair and deceptive acts and practices in commerce.

The Commission found the statements contained in the pamphlets were false and injurious to the aluminum industry and further found that the pamphlets supplied as "instrumentality by means of which uninformed or unscrupulous manufacturers, distributors, dealers and salesmen may deceive or mislead members of the purchasing public, and induce them to purchase utensils made from materials other than aluminum," and found the respondent guilty of "unfair and deceptive acts and practices in commerce." The Commission issued its cease and desist order and Scientific Manufacturing Company, Inc., petitioned the Circuit Court of Appeals for the Third Circuit, asking that the order be set aside.

In this case the court said:

> "The Commission contends that its jurisdiction in the circumstances shown derives from the amendment of March 21, 1938, (c. 49 Sec. 5 (a), 52 Stat. 111, 15 U.S.C.A. sec. 45 (a)) which enlarged the original Federal Trade Commission Act by adding thereto a denouncement of "unfair or deceptive acts or practices in commerce" and by correspondingly empowering and directing the Commission to prevent the use of such acts or practices. From this, the Commission

argues that the petitioners, being commercially engaged in an interstate business (the sale and distribution of pamphlets) are amenable to the Commission's interdictions when any of their acts or practices are found by the Commission to be unfair or deceptive in respect of some article of commerce in an *unrelated trade and notwithstanding such acts or practices are neither unfair nor deceptive in respect of the petitioners' trade in interstate commerce. * * * Obviously, a grant of power so vast is not to be accorded an administrative body except upon plain legislative direction within constitutional bounds. This brings us then to the matter of congressional intent for first consideration.*" (Italics provided).

Without equivocation the Third Circuit thus announced the principle of law that when petitioners' acts and practices are neither unfair nor deceptive in respect of the petitioners' trade in interstate commerce, the Commission has no jurisdiction to issue a cease and desist order. It is not claimed nor does the Commission contend or is it alleged or found that the petioners' acts complained of are "unfair or deceptive" in respect of the petitioners' trade.

Likewise, the court without equivocation applies the rule of "strict construction" to the Federal Trade Commission Act. Accordingly, no court can construe the Federal Trade Commission Act so as to rule that the Federal Trade Commission has power to restrain methods, acts, and practices which are not unfair or deceptive in respect of the petitioners' trade in interstate commerce. Such a power must have a plain legislative direction within constitutional bounds. This essential direction the court holds is not included within the statute creating the Federal Trade Commission.

The court also said:

"None the less, it was still the unfair acts of

> traders in the affected commerce that the Commission was empowered to enjoin * * * But the restrainable acts or practices in commerce continued to be such as are performed or perpetrated in the trade affected by the offenses, whether or not there is competition. In short, the Commission's intervention is limited to acts or practices in the affected trade. If the amendment were given any broader scope, the Act would relate to far more than trade practices * * *"

The power granted to the Commission must have some limit. The petitioners feel that the limits placed on the Commission by this case is logical and does not cramp the meaning of the Federal Trade Commission Act. Feeling this way the petitioners urge this Court to adpot this limitation and apply it to the case at bar.

THE CASE OF CHARLES A. BREWER AND SONS VS. FEDERAL TRADE COMMISSION.

The United States Circuit Court of Appeals for the Sixth Circuit in the case of *Charles A. Brewer & Sons,* 158 F (2) 74, sustained an order issued by the Federal Trade Commission identical with the order issued against these petitioners. The crux of the ruling in the case is set out clearly in the following paragraph:

> "For the reasons hereinafter appearing, we have reached the conclusion that, in thus aiding and abetting, inducing and procuring manufacturers and wholesale and retail dealers in merchandise to use unfair or deceptive acts or practices and unfair methods of competition, Charles A. Brewer and Son, though manufacturing no merchandise except the lottery devices which they ship in interstate commerce, fall within the restraining power of the Federal Trade Commission Act. (52 Stat. 111.)"

By so holding the Sixth Circuit construes this part of the Federal Trade Commission Act:

> "The commission is hereby empowered and directed to prevent persons, partnerships, and corporations * * * from using unfair methods of competition in commerce and unfair or deceptive acts in commerce."

to include the

> "aiding and abetting, inducing and procuring manufacturers and wholesale and retail dealers in merchandise to use unfair or deceptive acts or practices and unfair methods of competition, even though said acts or practices and unfair methods are intrastate."

In so construing the act the court ignored the rule of construction announced by the Supreme Court in the *Bunte* case, *supra,* and by this court in the case of *California Rice Industry.* The court announced this principle of law without referring to the Federal Trade Commission Act, the above two cases or any rules of statutory construction.

In all of the cases cited in the decision in the *Brewer* case to sustain the holding therein that *using* can be read as meaning "aiding and abetting, inducing and procuring" are cases where the one proceeded against was *using* a method in interstate commerce which *cast upon their competitors the burden of the loss of business unless they descended to a practice which they were under a powerful moral compulsion not to adopt.* Cases wherein this is the only principle of law involved are not authority nor precedent for the holding that *using* can be read as meaning "aiding and abetting, inducing and procuring." Also, they are not authority nor precedent for holding that the complained of acts of the petitioners are within the purview of the Federal Trade Commission Act.

The first case cited in the *Brewer* case to sustain this broad interpretation of the word "using" is the case of *Fed-*

eral Trade Commission vs. Winsted Hosiery Company, 258 U. S. 483. This case is not in point nor does it contain any comment or any holding which in any way can be construed to justify the Sixth Circuit in holding that the word *using* can be interpreted to mean "aiding and abetting, inducing and procuring." The following discussion of the *Winsted* case is limited to its application in the *Brewer* case.

In passing, the petitioner wishes to point out that the *Winsted* case comes within the rule of law announced in the case of *Scientific Manufacturing Company vs. Federal Trade Commission, supra,* and certainly it is not *contra* to it for all of the evil results of the use of such methods by the Winsted Company were unfair in respect of its trade in interstate commerce. The case at bar does not.

The *Winsted* case, *supra,* also comes within the criterion that the method, act or practice must be either unfair to competitors or purchasers, because the method used by the Winsted Hosiery Company, *supra,* was both unfair to competitors and to purchasers. Petitioners acts are not unfair to either.

The Winsted Hosiery Company made a product consisting of wool and cotton which they mislabeled as all wool. This cast upon Winsted Company's competitors the burden of loss of business unless they descended to a practice which they were under a powerful moral compulsion not to adopt. This was the unfair method of competition used by the company and the Commission restrained them, not from shipping this product in commerce, but from using the method of misbranding it. The Supreme Court, in discussing the effect of this practice, said:

> "And they (the facts in the case) show also that the *practice constitutes an unfair method of competition as against manufacturers of all wool knit underwear and as against those manufacturers of mixed wool and cotton underwear who brand their products truthfully. For when misbranded goods attract custo-*

mers by means of the fraud which they perpetrate, trade is diverted from the producer of truthfully marked goods." (Italics provided).

The court says further:

> "The honest manufacturer's business may suffer, not merely through a competitor's deceiving his direct customer, the retailer, but also through the competitor's putting into the hands of the retailer an unlawful instrument, which enables the retailer to increase his own sales of the dishonest goods, thereby lessening the market for the honest product. *That a person is a wrongdoer who so furnishes another with the means of consummating a fraud has long been a part of the law of unfair competition.*" (Italics supplied).

Thus the Supreme Court holds that the practice of misbranding is an unfair method of competition upon and for the sole reason that, as stated by the court:

> "For when misbranded goods attract customers by means of the fraud which they perpetrate, trade is diverted from the *producer* of truthfully marked goods." (Italics provided).

This shows that the essence of the holding in the *Winsted* case, *supra,* is that the honest *manufacturer's* business suffers when his competitor places in the hands of another his dishonest goods, this casts upon its competitors the burden of loss of business unless they descended to a practice which they were under a powerful moral compulsion not to adopt.

It will be noted that the Sixth Circuit Court, in its opinion in the *Brewer* case, when quoting from the *Winsted* case, *supra,* italicized the following sentence contained in the quote:

> "That a person is a wrongdoer who so furnishes

another with the means of consummating a fraud has long been a part of the law of unfair competition."

When the Circuit Court plucked this sentence out of the quoted portions of the *Winsted* case and isolated it from all the rest of the Supreme Court opinion it is safe to assume that the court in deciding the *Brewer* case, concluded that this sentence established the principle of law that placing in the hands of others the means by which the Federal Trade Commission Act is violated is an unfair act within the corrective power of the Federal Trade Commission.

The Court again, after citing another case, says:

> "The opinion recognizes the principle of the *Winsted Hosiery Company* case, *supra,* that wrongfully furnishes another with the means of consummating a fraud is an established part of the law of unfair competition."

The Commission also contends that this sentence settles all of the issues in the case at bar adversely to the petitioners.

The sentence in the *Winsted* case, *supra,* relied upon by the Sixth Circuit Court does not say, as the court assumes and interprets it to say, "that a person is a wrongdoer who * * * furnishes another with the means of consummating a fraud has long been a part of the law of unfair competition."

Where the petitioners have placed the asterisks, the Supreme Court has placed the word "so." Therefore, the sentence reads "who so furnishes" which means who so furnishes the means to commit a fraud by which the one who furnishes the means of perpetrating the fraud thereby has an unfair advantage over his competitors in interstate commerce, and, also, casts upon its competitors the burden of loss of interstate business unless they descended to a practice which they are under a powerful moral compulsion not to adopt. The petitioners do not *"so furnish"* any such means because, as has

been pointed out, the acts of petitioners complained of do not give petitioners any unfair advantage over their competitors, nor do the petitioners cast upon its competitors the burden of loss of business unless they descended to a practice which they are under a powerful moral compulsion not to adopt.

In making such a broad interpretation of this sentence the Court of Appeals for the Sixth Circuit, and the Federal Trade Commission are clearly in error. The fallacy of such a broad interpretation of this sentence will appear self evident when the facts and principles of law involved in the *Winsted* case, *supra,* are compared with the facts of the case at bar.

The method used by the Winsted Hosiery Company, *supra,* were held to be within the interdiction of the Federal Trade Commission on the sole and only ground, that the Winsted Company was using "an unfair method of competition in interstate commerce, because by using said methods the Winsted Company had an unfair advantage over all of its competitors in interstate commerce. In the absence of this condition the Federal Trade Commission has no jurisdiction.

This condition is certainly not present in the present case. Petitioners do not have any unfair advantage over their competitors. This should be conclusive of the case.

This sentence under discussion cannot be read to mean that one who furnishes another with a punch board which is used to distribute merchandise, *not the merchandise of the one who furnishes the punch boards* but the merchandise of the user thereof, comes within the grant of power contained in the following portion of the Federal Trade Commission Act:

> "The commission is hereby empowered and directed to prevent persons, partnerships, and corporations * * * from using unfair methods of competition in commerce and unfair or deceptive acts in commerce."

The Winsted Company furnished the entire means of consummating the fraud while the petitioners only furnish

a part of the assortment, the punch board; the merchandise is furnished by another.

Petitioners are not charged with using an unfair method of competition. The rule of law announced in the disputed sentence is limited to the law applicable to such a method. A principle of law exclusively applicable to the law of unfair methods of competition is not applicable to some other act or practice.

The Supreme Court in the *Winsted* case cites the case of *Coca Cola Company vs. Gay-Ola Company,* 200 Fed. 120 (C.C. A. 6) in support of its holding. This case is one wherein the conduct of the wrongdoer was leading purchasers to believe that they were purchasing Coca Cola's product when in fact they were acquiring the product of the Gay-Ola Company. In this case the Sixth Circuit Court laid down the same rule as is laid down in the *Winsted* case. This case did not involve the Federal Trade Commission or its power. It was a case of just "unfair competition" but it did turn on the point that the wrongdoer had an unfair advantage over his competitors in interstate commerce, which petitioners contend is essential to the application of this rule of law.

In addition to the element of unfair advantage by a wrongdoer over his competitors, the proceeding in the *Winsted* case, *supra,* was against the *using of the method* not the *stopping of the shipping of merchandise.*

What has been said about the *Winsted* case, *supra,* applies with equal force to the other two cases, *Chicago Silk Company vs. Federal Trade Commission,* 90 F. (2) 689, and *Deer vs. Federal Trade Commission,* 152 F. (2) 65, which are cited in the *Brewer* case, in support of the same proposition. Not one of the above cases is in point herein because in each of them the methods, acts and practices proceeded against were unfair methods of competition. The petitioners are not charged with using such a method.

After stating that both *Raladam* cases were before the

Wheeler Lea Amendment, the court says, speaking of the Amendment:

> "This makes it now necessary that effect on competition be shown. *For discussion of the effect of this amendment see* Pep Boys—Manny, Moe, and Jack, Inc., vs. Federal Trade Commission, 122 F. (2) 158, 161 (C.C.A. 3); Scientific Manufacturing Company vs. Federal Trade Commission, 124 F. (2) 640, 643 (C.C.A. 3)." (Italics supplied.)

The petitioners cite both of these cases in support of their case. As shown above the *Pep Boys—Manny, Moe, and Jack, Inc., vs. Federal Trade Commission,* holds, and for emphasis the following is repeated, quoting from the case of *Pep Boys—Manny, Moe, and Jack, Inc., vs. Federal Trade Commission, supra*:

> "The failure to mention competition in the later phrase shows a legislative intent to remove the procedural requirement set up in the Raladam case and the Commission can now center its attention on the *direct protection of the consumer* where formerly it could protect him only indirectly through the protection of the competitor." (Italics provided).

The discussion as to the effect of the Amendment in the *Scientific Manufacturing Company, supra,* is directly in conflict with the holding in the *Brewer* case, wherein it is cited. If the Sixth Circuit Court had followed what was said in these cases after having cited them with approval, the court would have decided the *Brewer* case against the Commission.

Next, the court in the *Brewer* case cites several cases decided by the Seventh Circuit. Unfair methods of competition are not in point in the *Brewer* case because they have (1) used a method; (2) the method used was unfair to competi-

tors. These cases are not authority or precedent for holding that "aiding and abetting, inducing and procuring others," is within the Federal Trade Commission Act. In all of these cases the persons proceeded against were *using* an unfair method of competition in commerce because in each case the Federal Trade Commission had made a finding in effect that their competitors were forced to use a method or practice which they were under a powerful moral compulsion not to use, or suffer a loss of substantial trade. There is no such finding made in the case at bar. First, the petitioners' acts are not being *used* nor do the petitioners cast upon their competition the burden of loss of business unless they descend to a practice which they are under a powerful moral compulsion not to adopt.

It is now necessary to first determine if that portion of the opinion in the *Modernistic Candies* relied upon not only by the Commission, but also, by the Sixth Circuit Court of Appeals is dictum, and then it must be determined whether or not the principle announced therein is or is not in conformity with the law as announced by the Supreme Court. The portion of the opinion in the *Modernistic* case relied upon by the Sixth Circuit, under discussion here is as follows:

> "It is clear that the Federal Trade Commission has the power to eradicate merchandising by gambling in interstate commerce. We think the Commission also has the power to prohibit the distribution in interstate commerce of devices intended to aid and encourage merchandising by gambling. The gamblers and those who deliberately and designedly aid and abet them are both engaged in practices contrary to public policy. Merchandising by gambling should not be divided into isolated acts, which appear innocent when examined separately. This unfair practice should be viewed as a whole. If the Federal Trade Commmission is to police merchandising by gambling, it must police those

who designedly and *deliberately aid and abet this practice. We think the Commission has such power.*"

The following analysis of the issues presented in the *Modernistic* case will make it self-evident that the above quoted portion of the opinion is dictum.

The Modernistic Candies Company was engaged in the business of selling gum. This is of vital importance in this analysis. The company was not engaged in selling any kind of gambling device independent or separate from its gum. The act or practice proceeded against was the act and practice of placing balls of gum in holes in a laminated board. This contrivance was sold in interstate commerce and when used, customers would buy Modernistic's gum by pushing out from one of the holes a concealed ball of gum. Some of the balls were winners and prizes were awarded to the people who were lucky enough to punch out a winning ball of gum. In this case the Modernistic Candies was clearly using the chance device to sell its gum. This places this case in the category with all of the other chance cases wherein the party proceeded against was *using* a chance device to sell their merchandise. This practice of selling one's merchandise in interstate commerce accompanied with a chance device has been held to be unfair to competitors and therefore, because such practice is unfair to competitors and for this reason alone this practice has been held to be within the meaning of the Federal Trade Commission Act. The issues involved therein were limited strictly to this issue.

As the only issue in the case was, does the practice of selling assortments consisting of merchandise and a chance device by a person engaged in the selling of merchandise, but not engaged in the business of selling chance devices otherwise than with his merchandise come within the interdiction of the Federal Trade Commission, any and all statements or comments made by the court in this case concerning the legal effect of the mere selling of a chance device which is to be used for the purpose of distributing merchandise is mere dictum of the highest type.

If the issue of whether or not the furnishing of a chance device is an unfair act within the meaning of the Federal Trade Commission had been presented in this *Modernistic* case the attorney for the petitioner therein would have cited the *Bunte* case, *supra*; and the Seventh Circuit Court in the face of what the Supreme Court held in that case would not have said:

> "We think the Commission also has the power to prohibit the distinction in interstate commerce of devices intended to aid and encourage merchandising by gambling."

nor would the court have said:

> "If the Federal Trade Commission is to police merchandising by gambling, it must police those who designedly and deliberately aid and abet this practice. We think the commission has such power."

Petitioners make this statement because the Supreme Court in the *Bunte* case held unequivocally that the Federal Trade Commission is *not* to police the intrastate merchandising by gambling.

The statement is not only dictum but the principle of law announced therein is not sound. There is no sound principle of statutory construction that in an act creating an administrative agency the words, "using an unfair method of competition and unfair or deceptive acts or practices" can be construed to include the furnishing of just some of the means by which others violate the act.

The decision in the *Brewer* case is unsound because it is predicated upon the following unsound principle of law announced in the dictum in the *Modernistic* case, *supra,* to wit:

> "If the Federal Trade Commission is to police merchandising by gambling, it must police those who

designedly and deliberately aid and abet this practice. We think the commission has such power."

This principle of law is unsound because the Supreme Court in the *Bunte* case, *supra,* held that the Commission has no power to police merchandising by gambling.

The following cases cited in the *Brewer* opinion: *Ostler Candy Co. v. Federal Trade Commission,* 106 F. (2) 962; *Federal Trade Commission v. F. A. Martoccio Co.*, 87 F. (2) 561; *Deer v. Federal Trade Commission,* 152 F. (2) 65; and *Parke, Austin & Lipscomb v. Federal Trade Commission,* 142 F. (2) 437, cited by the Sixth Circuit, are all in the same category as the cases cited from the Seventh Circuit. All of these cases involved *only* and *solely* the principle of law that the facts as found by the Commission in each of the cases constituted the *using* in interstate commerce of "an unfair method of competition." In as much as the Commission admits that petitioners are not using an unfair method of competition, these cases have no bearing upon the issues joined in the *Brewer* case or in the case at bar. They certainly are not authority or precedent for holding that "in" can be read as aiding and abetting, inducing or procuring.

The offhand treatment of the case of *Federal Trade Commission vs. Bunte Brothers, Inc.,* 312 U.S. 349 by the Sixth Circuit Court in the closing part of its opinion in the *Brewer* case convinces the petitioners that the Sixth Circuit did not understand the important bearing the *Bunte* case has upon the issues raised in the *Brewer* case and in the case at bar.

From what has been said heretofore about the *Bunte* case and the *Winsted* case, it is self-evident that the petitioners contend that the *Bunte* case is of vital importance in at least two aspects in deciding a case involving the issues raised in the case at bar; first, the *Bunte* case holds that the Federal Trade Commission Act must be strictly construed; second, that intrastate transactions are not in the purview

of the Federal Trade Commission Act; and that petitioners further contend that the *Winsted* case is of no importance to the resolving of such issues; while on the other hand, the Sixth Circuit Court holds that the *Bunte* case is not of importance and that the *Winsted* case is absolutely controlling.

What the petitioners are hoping to do is to convince this court that their contention is correct and the Sixth Circuit Court of Appeals is wrong.

From this discussion of the *Brewer* case, it seems self-evident that this case should not be followed.

THE ORDER IS TOO BROAD

If this court should hold that the Federal Trade Commission has power to stop the petitioners from shipping punchboards to others who will use them in such a manner as to violate the Federal Trade Commission Act, the order should be modified so that petitioners are not restrained from shipping their punchboards to people who are engaged only in intrastate transactions.

Also, the following portion of the order should be stricken: "* * * or may be used."

Petitioner's authority for this change is the case in this court of *Lee Boyers Candy v. Federal Trade Commission,* 128 F. (2) 261.

THIS PROCEEDING IS NOT IN RESPECT THEREOF TO THE INTEREST OF THE PUBLIC.

They can call them orders to cease and desist, but in reality the orders issued by the Federal Trade Commission are injunctions. Therefore, some of the salutary aspects of the law of injunctions should be given the proper respect in proceeding under the Federal Trade Commission Act when looking forward to the issuing of a cease and desist order.

Injunction proceedings have always been held to be an extraordinary remedy, resorted to only when there is no

other adequate remedy at law or where irreparable injury will result in the injunction does not issue forthwith. Also, injunctions have never been recognized as a proper remedy in criminal law. Under such circumstances injunction proceedings would not be entertained as an indirect proceeding when there is available an adequate and effective direct proceeding, especially when the indirect proceeding is cumbersome, roundabout, expensive, ineffective, and practically a nullity. While, on the other hand, the direct proceeding is inexpensive, straight to the point, and effective.

From the order issued herein the supposed evil that the Commission is endeavoring to eradicate is the use of chance to distribute merchandise. This proceeding is not a direct proceeding against this practice, but is an indirect proceeding against punch boards, not the use of them. It is not even a proceeding against chance itself, but is only against one minor device among numerous chance devices used in the distribution of merchandise, which makes this proceeding ineffectual and practically a nullity.

The present proceeding is only what might be called a declaratory proceeding, for it only declares that the acts proceeded against are in violation of the Federal Trade Commission Act, and thereafter, there must be further proceedings if there is a violation. On the other hand, the states have a direct, inexpensive way of eliminating and eradicating the distribution of merchandise by chance if they choose to do so, and if they do not, the Federal government should not interfere with such local transactions.

This is also true of the situation wherein punch boards are used in assortments, which assortments are shipped in interstate commerce. The Federal Trade Commission by proceeding directly against this practice has been fully successful in eradicating it. There is no need of bringing a proceeding to stop the furnishing of punch boards to people who use them in connection with the violation of the Federal

Trade Commission Act when the direct proceeding against that practice is adequate to stamp it out.

This statement from the first *Raladam* case, *supra,* is injected here:

> "Certainly, it is hard to see why Congress would set itself to the task of devising means in creating administrative machinery for the purpose of preserving the business of one knave from the unfair competition of another."

Why the petitioners inject this quotation at this time is so that they can say:

> "Certainly, it is hard to see why Congress would set itself to the task of devising means and creating administrative machinery for the purpose of conducting cumbersome, roundabout, expensive, ineffective proceedings, when there is a direct, inexpensive and effective remedy available."

There are two prerequisites before the Commission can proceed; first, there must be present either an unfair method of competition or an unfair or deceptive act or practice used in interstate commerce; and second, it must appear that a proceeding by the Commission against the use of the unfair method, act or practice would be in respect thereof to the interest of the public. The public interest present in the Federal Trade Commission Act is limited to the interest the public may have in the elimination of the use of the unfair method, act or practice. If the elimination of the unfair method, act or practice is not to the interest of the public the Commission does not have jurisdiction to proceed, and the complaint must be dismissed. This is true because Congress did not and never intended to give the Commission power or jurisdiction to proceed generally in the interest of the public. The act creating the Commission and giving

it power contains absolutely no substantive words of protection of the public. The only substantive words of protection used in the act are protection against the use of unfair methods of competition and unfair and deceptive acts and practices. The only words in the act concerning public interest are words of limitation upon the Commission's power and are not substantive words of protection.

On this point the Supreme Court in the case of *Federal Trade Commission v. Raladam,* 283 U. S. 643 held unequivocally that the provision of the creative act requiring that proceedings by the Commission must be to the interest of the public is not a part of the substantive protection of the act but is a limitation on the protective power and jurisdiction granted. The court says, page 648:

> "By these additional words, protection to the public interest is made of paramount importance but, nevertheless, they are not substantive words of protection, but complimentary words of limitation beyond the jurisdiction conferred by the language immediately preceding."

A careful reading of the first part of (b) of Sec. 5 of the Federal Trade Commission Act will show that this is the only interpretation that can be given to this part of the act. The act provides on this point as follows:

> "Whenever the Commission shall have reason to believe that any such person, partnership, or corporation has been or is using any unfair method of competition or unfair or deceptive act or practice in commerce, and if it shall appear to the Commission that a proceeding by it *in respect thereof* would be to the interest of the public, it shall issue * * *." (Italics provided).

As it is a prerequisite to the Commission proceeding

herein that this proceeding must be against either an unfair method of competition or an unfair act or practice which it is to the interest of the public to have stopped, we must first determine what unfair act or practice the Commission intends to eliminate by this proceeding and, next, we must determine whether or not this proceeding will effect the elimination.

The unfair act that this proceeding is aimed at is the practice of retailers using chance to distribute merchandise. It follows that the issuing of a cease and desist order against this petitioner herein will not eradicate this unfair act of retailers; therefore, this proceeding is not to the interest of the public and for that reason must be dismissed.

From the very nature of the situation an order against the petitioner will not have any effect upon this unfair act. An analysis of the practice sought to be eliminated will make the truth of this statement obvious. That punch boards are only one of the many chance devices used by the so-called retailers in their obnoxious practice of distributing merchandise by chance is of controlling effect herein. As the retailers use many different kinds of chance devices the elimination of one or even more of these devices will not in any manner decrease the amount of merchandise distributed by chance nor will it decrease the amount of money spent on chance. Consequently, if the Commission were able to prevent completely the retailers from obtaining punch boards the distribution of merchandise by chance would still go on unaffected. The petitioner's case is much stronger than this because the Commission's lack of power to stop the intrastate distribution of punch boards and of all other chance devices prevents it from stopping the retailers from obtaining chance devices. As long as retailers can obtain chance devices or create them they will use chance to distribute merchandise. Therefore, if a cease and desist order should be issued against petitioner the use of chance by retailers to distribute merchandise would go on unaffected.

In addition to the fact that retailers use many different kinds and types of chance devices they have many sources of supply which are not within the purview of the Federal Trade Commission Act. This fact, also, is very important in determining if this proceeding is "in respect thereof to the interest of the public."

The source from which the retailer obtains the chance device he uses or whether it had moved in interstate commerce, or not, has no effect upon the use of it. Whether the chance device came in interstate commerce or from petitioner's factory intrastate in New York, the effect of its operation in New York is the same.

Also, the effect of the use of chance in this regard is the same when a retailer in New York, for illustration, uses punch boards which have been distributed in interstate commerce from which his customers select slips of paper upon which there is a printed number as when the same retailer uses a jar or some other container from which his customers select slips of paper upon which the retailer has stamped a number or when the retailer uses a spindle or a pad upon which a local printer has attached slips of paper upon which he has printed numbers.

This fact is very important herein because it must be conceded that the Commission has no power to prevent the New York manufacturer from supplying the New York retailer with punch boards, nor can the Commission stop the local printer from furnishing the local retailer with pads and spindles, and the Commission is without power to stop the local retailer from making his own spindles, pads or putting slips of paper in a container upon which he has printed or stamped numbers. It must also be conceded that the Commission cannot prevent the said retailers from obtaining all of the other numerous chance devices used by retailers in the distribution of merchandise by chance such as dice, cards and all kinds of slot machines, including the so-called pin ball machines.

From this, it is certain that the stopping of the interstate distribution of punch boards has absolutely no effect upon the use of chance in the distribution of merchandise. Add to this that this proceeding is merely against this respondent, and the futility of this proceeding in regard to to effecting the elimination of the practice of using chances in the distribution of merchandise is made self-evident.

For the reason hereinabove set forth, the petitioner respectfully requests this court to set aside the order issued herein.

Respectfully submitted,

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No. 12796

In the United States Court of Appeals for the Ninth Circuit

BORK MANUFACTURING CO., INC., A CORPORATION, AND ALVIN BORKIN, AN INDIVIDUAL AND PRESIDENT OF BORK MANUFACTURING CO., INC., PETITIONERS

v.

FEDERAL TRADE COMMISSION, RESPONDENT

ON PETITION TO REVIEW AN ORDER OF THE FEDERAL TRADE COMMISSION

BRIEF FOR RESPONDENT

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In the United States Court of Appeals for the Ninth Circuit

No. 12796

BORK MANUFACTURING CO., INC., A CORPORATION, AND ALVIN BORKIN, AN INDIVIDUAL AND PRESIDENT OF BORK MANUFACTURING CO., INC., PETITIONERS

v.

FEDERAL TRADE COMMISSION, RESPONDENT

ON PETITION TO REVIEW AN ORDER OF THE FEDERAL TRADE COMMISSION

BRIEF FOR RESPONDENT

I. STATEMENT OF THE CASE

This is an administrative law proceeding arising upon petition to review and set aside order to cease and desist issued by the Federal Trade Commission, respondent, pursuant to a Commission complaint charging petitioners with engaging in unfair acts and practices in commerce in violation of the Federal Trade Commission Act.[1]

[1] The pertinent provisions of the Statute are as follows:

"SEC. 5. (a) Unfair Methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are hereby declared unlawful.

"The Commission is hereby empowered and directed to prevent persons, partnerships or corporations * * * from using un-

The complaint, issued on the 9th day of January, 1948, alleged (Tr. R. p. 3–6) that Bork Manufacturing Co., Inc., a corporation (hereinafter referred to as "Bork"), and Alvin Borkin, an individual and President of "Bork", petitioners, with their principal office located at 6201 Fifteenth Avenue, Brooklyn, N. Y., were engaged in the manufacture, and in the sale and distribution in interstate commerce, of various types of punch boards and push cards—some containing instructions or legends printed thereon, others with blank space provided for such printed matter—all so prepared and arranged that the only use to be made thereof and the only manner in which they are used is in selling merchandise to the ultimate purchaser by means of lot or chance; that petitioners sell their push cards and punch boards to manufacturers of, and dealers in, various articles of merchandise in interstate commerce.

The complaint further alleged (Tr. R. pp. 6–7) that many persons, firms and corporations who distribute merchandise in interests commerce and in the District of Columbia purchase petitioners' push cards and punch boards and assemble assortments of merchandise with said push cards and punch boards; that retail dealers have purchased such assortments and exposed the same to the purchasing public and have sold such merchandise by means of said push cards and punch boards; that because of the element of chance involved, many members of the purchasing

fair methods of competition in commerce and unfair or deceptive acts or practices in commerce." 52 Stat. 111–112; 15 U. S. C. 45 (a).

public have been induced to buy from such retail dealers who use petitioners' push cards and punch boards to sell their merchandise and as a result many retail dealers have been induced to deal or trade with manufacturers, wholesale dealers and jobbers who distribute the push cards and punch boards with their merchandise.

The complaint further alleged (Tr. R. p. 7) that the sale of merchandise to the public by the use of push cards and punch boards involves a game of chance or the sale of a chance to procure merchandise at less than normal retail prices; that the sale of merchandise by this manner and means teaches and encourages gambling among members of the public all to the injury of the public; that sale of merchandise by chance or lottery is a practice which is contrary to an established public policy of the Government of the United States and in violation of criminal laws and constitutes an unfair act and practice in commerce.

The complaint further alleged (Tr. R. pp. 7–8) that by the sale of their push cards and punch boards petitioners supply and place in the hands of others the means of conducting lotteries, games of chance or gift enterprise in the sale or distribution of merchandise, thus providing others with the means of, and instrumentalities for, engaging in unfair acts and practices in violation of the Federal Trade Commission Act.

On the basis of the above allegations the complaint charged (Tr. R. p. 8) that the acts and practices of petitioners were all to the injury of the public and

constitute unfair acts and practices in commerce in violation of the Federal Trade Commission Act. In their answer filed on the 30th day of January 1948, signed by their then attorneys, petitioners denied all material allegations of the complaint. However, at the initial hearing held on the 23d day of September 1948, petitioners through their counsel requested permission to withdraw their original answer and file in lieu thereof a substitute answer in which all the material allegations of facts alleged in the complaint were admitted, denying, however, that such facts constituted a violation of the Federal Trade Commission Act. On March 14, 1950, the Trial Examiner closed the hearings and transmitted to the Commission the undated admission answer of petitioners.

Thereafter on the 24th day of October 1950, the Commission made its findings as to the facts (Tr. R. pp. 17–22), which accorded with the allegations of the complaint as above outlined and as admitted by petitioners, concluded (Tr. R. pp. 22–23) that petitioners' acts and practices were "all to the prejudice and injury of the public and constitute unfair acts and practices in commerce within the intent and meaning of the Federal Trade Commission Act" and entered its order (Tr. R. pp. 23–25) to cease and desist.

There is no dispute as to the facts found by the Commission. Petitioners' sole contention here is that such facts do not violate the Federal Trade Commission Act. The facts as found by the Commission are substantially, if not exactly, those alleged in the complaint—a brief summary of which we have set forth

herein above (*supra,* pp. 2–3). Upon the basis of the admitted facts and upon the conclusion arrived at by the Commission from those admitted facts, the Commission entered its order (Tr. R. pp. 23–25), directing Bork Manufacturing Co., Inc., its officers, agents, representatives, and employees, and Alvin Borkin, individually and as an officer of "Bork", his agents, representatives and employees, to cease and desist from:

> Selling or distributing in commerce, as "commerce" is defined in the Federal Trade Commission Act, punch boards, push cards or other lottery devices which are to be used or may be used in the sale or distribution of merchandise to the public by means of a game of chance, gift enterprise, or lottery scheme.

Petitioners thereafter filed their petition to review and set aside the Commission's order (Tr. R. pp. 32–35), and filed a statement of eight points relied upon (Tr. R. p. 36). The alleged points not developed or argued in their brief may be deemed abandoned. *Donnelley* v. *United States,* 276 U. S. 505, 511 (1928); *Eastman Kodak Co.* v. *Southern Photo Materials Co.,* 273 U. S. 359, 369 (1927).

II. THE CONTESTED ISSUES

The attorneys for petitioners in the instant matter are also attorneys for petitioners in the *Lichtenstein* case, No. 12666, now pending in this court, and in their brief here they have developed their argument almost indentical with their brief in the *Lichtenstein* case, stating the same question presented and the assignment of the same errors, developing their argu-

ment under the following headings—unnumbered as in the *Lichtenstein* brief but also, in some instances, not even set out in bold type as in the *Lichtenstein* brief: (1) "the rule of strict construction must be applied to the Federal Trade Commission Act" (Pet.'s br. p. 8); (2) "under what principle of law is the Commission proceeding" (Pet.'s br. p. 9); (3) "that petitioners' acts are not unfair methods of competition and not unfair acts within the meaning of the Federal Trade Commission Act" (br. pp. 11–15); (4) "petitioners are not using any acts, methods, or practices" (Pet.'s br. pp. 15–31); (5) "the order is too broad" (Pet.'s br. pp. 10–11, 31); (6) "this proceeding is not in respect thereof to the interest of the public" (Pet.'s br. pp. 31–37).

Unlike the *Lichtenstein* case—No. 12666—petitioners in the instant matter admitted all of the material allegations of the complaint. Petitioners admitted that they were engaged in the sale of punch boards and push cards in interstate commerce; admitted that such punch boards and push cards were designed and sold for the sole purpose of enabling others to sell merchandise to the public by means of gift enterprise, game of chance or lottery. Petitioners' sole contention here therefore is: admitting the facts as found by the Commission such facts do not constitute a violation of the Federal Trade Commission Act and, therefore, the Federal Trade Commission is without jurisdiction to issue the order here involved. We, therefore, believe that for simplicity, clarity and conciseness the question presented can be stated as follows:

(1) Whether the Federal Trade Commission has jurisdiction to prohibit the sale and distribution in interstate commerce of punch boards and push cards designed and sold for the purpose of enabling others to sell merchandise to the public by means of a game of chance, gift enterprise or lottery.

III. ARGUMENT

Preliminary statement

Although a large portion of petitioners' brief and the citations of authorities have to do with the question of unfair methods of competition and deceptive acts and practices, those questions are not here involved. The Commission did not charge nor did it find that, in the sale and distribution of punch boards and push cards in interstate commerce, petitioners were engaged either in unfair methods of competition or deceptive acts and practices. The *finding* was that petitioners *were engaged in unfair acts and practices in interstate commerce in violation of the Federal Trade Commission Act.* Petitioners' argument here, just as in the Lichtenstein brief, is a confusing mixture of irrelevant matter, academic discussions and "illogical syllogistical" reasoning and in many instances a distortion of applicable principles of law.

Relying on *Federal Trade Commission* v. *Raladam,* 283 U. S. 643 (1931); *Federal Trade Commission* v. *Klesner,* 280 U. S. 19 (1929) and *Federal Trade Commission* v. *Bunte Bros.,* 312 U. S. 349 (1941), petitioners contend that the scope of the authority of the Federal Trade Commission is strictly limited and that the rule of strict construction must be applied

to the Federal Trade Commission Act (br. p. 8); petitioners state that in the face of the Supreme Court decision in the *Bunte* case—where the court held that the Federal Trade Commission had no jurisdiction over intrastate transactions—they cannot comprehend what theory or principle of law the Commission is relying upon to sustain its jurisdiction to issue an order as broad as the instant order (Pet.'s br. pp. 9–11). Petitioners then discuss the meaning of the word "unfair" and upon the basis of the decision of the court in the *Raladam* case arrive at the conclusion that their methods and practices are not unfair to competitors, to purchasers or to both; that the decision in the *Raladam* case limits the meaning of the word "unfair" to methods, acts or practices either unfair to competitors, to purchaser or to both (br. pp. 11–14).

Having thus relied on the *Raladam* case petitioners then do a strange thing, they cite *Pap Boys—Manny, Moe & Jack, Inc.* v. *Federal Trade Commission,* 122 F. 2d 158 (C. A. 3, 1941), to show that the rule laid down in the *Raladam* case is *no longer applicable*—and therefore their methods, acts and practices are neither unfair to competitors nor purchasers (br. pp. 14–15).

Petitioners next engage in some grammatical gymnastic contortions that would strain the reasoning powers of the most ardent semantic and come up with the conclusion that if the word "in" as used in the Federal Trade Commission Act means only "in" and not something else; then, obviously, the word "using" as it appears in the Federal Trade Commission Act

must of necessity mean only "using." Based upon this remarkable conclusion and relying upon this court's decision in *California Rice Industries* v. *Federal Trade Commission,* 102 F. 2d 716 (C. A. 9, 1939), and the Supreme Court's decision in the *Bunte* case, petitioners assert that they do not use any method, act or practice in interstate commerce—a startling assertion to say the least (br. pp. 15–16).

Petitioners then attempt to analyze *Scientific Manufacturing Co., Inc. et al.* v. *Federal Trade Commission,* 124 F. 2d 640 (C. A. 3, 1941) and *Chas. A. Brewer & Sons* v. *Federal Trade Commission,* 158 F. 2d 74 (C. A. 6, 1946), in an effort to demonstrate that their acts and practices are not unfair and deceptive "in respect of the petitioners' trade in interstate commerce" (br. pp. 16–31)—weaving into the confused pattern of their argument a discussion of *Federal Trade Commission* v. *Winsted Hosiery Company,* 258 U. S. 483 (1922), (br. pp. 21–26); a discussion of the cases cited by the courts in the opinions in the *Winsted* case (br. p. 25) and in the *Brewer* case (br. pp. 25–27, 30); an attempted analysis of *Modernistic Candies, Inc. et ed.* v. *Federal Trade Commission,* 145 F. 2d 454 (C. A. 7, 1944)—all of which but adds further confusion to petitioners' argument. Petitioners then emerge with the final conclusion (br. pp. 30–31) that: the decisions in the *Modernistic* and the *Brewer* cases are unsound—those should have been decided differently; since intrastate transactions are not in the purview of the Federal Trade Commission, the proceeding in the instant matter is controlled by the decision of the Supreme Court in the *Bunte* case; the

Winsted case is of no importance to the resolving of the issues here; and they hope to convince the court that their contention is correct, the Sixth Circuit Court of Appeals' decision in the *Brewer* case is wrong, and this court should not follow that decision.

Petitioners' entire brief here, like petitioners' brief in the *Lichtenstein* case, begs the question, ignores the admitted facts, and confuses the applicable principles of law. We, therefore, do not believe it would serve any useful purpose if we attempted to answer in detail each of the many varied patterns, related or otherwise, of petitioners' argument. We shall, therefore, confine ourselves to the one question presented and, since the facts are admitted by petitioners, of a discussion of the applicable law.

Petitioners' argument ignores two basic fundamental principles firmly established in cases involving the sale and distribution of goods by the means of game of chance, gift enterprise, or lottery scheme. They are:

(1) The sale of goods by a plan or method which involves the use of a game of chance, gift enterprise, or lottery is a practice which is contrary to an established policy of the Government of the United States and is an unfair method of competition and an unfair act and practice in violation of the Federal Trade Commission Act; and

(2) Supplying to or placing in the hands of others the means or methods of conducting a game of chance, gift enterprise, or lottery in the sale and distribution of merchandise is an unfair method of competition

nd an unfair act and practice in violation of the ederal Trade Commission Act.

The court should, therefore, bear in mind that petiioners admit that they sell and distribute in interstate ommerce punch boards and push cards designed and sed for no other purpose than that of selling merandise by means of a game of chance, gift enterprise c lottery. Petitioners, therefore, admit that they violate the Federal Trade Commission Act. This should be a complete and sufficient reply to their argument.

To avoid repeating citations to certain fundamental ules of law, which are applicable throughout this brief, we remind the court in the beginning of the following principles:

The validity of the Commission's order is settled b many authorities.

> *Lee Boyer's Candy* v. *Federal Trade Commission,* 128 F. 2d 261 (C. A. 9, 1942); *Helen Ardelle* v. *Federal Trade Commission,* 101 F. 2d 718, 719 (C. A. 9, 1939); *Federal Trade Commission* v. *Winsted Hosiery Co.,* 258 U. S. 483 (1922); *Federal Trade Commission* v. *Keppel & Brother, Inc.,* 291 U. S. 304 (1934); *Chas. A. Brewer & Sons* v. *Federal Trade Commission,* 158 F. 2d 74 (C. A. 6, 1946); *Modernistic Candies, Inc.* v. *Federal Trade Commission,* 145 F. 2d 454 (C. A. 7, 1944); *Deer* v. *Federal Trade Commission,* 152 F. 2d 65 (C. A. 2, 1945); *National Candy Co.* v. *Federal Trade Commission,* 104 F. 2d 999 (C. A. 7, 1939), cert. den. 308 U. S. 610 (1939); *Jaffe* v. *Federal Trade Commission,* 139 F. 2d 112 (C. A. 7,

1943), cert. den. 321 U. S. 791 (1944) and scores of others.

Such progression as there has been in the remedy embodied in the Commission's orders against lottery methods has resulted from evasion by practitioners of these methods; and was of a type anticipated when the Act was passed.

Federal Trade Commission v. *Beech-Nut Packing Company,* 257 U. S. 441, 453 (1922); *National Candy Co.* v. *Federal Trade Commission,* 104 F. 2d 999, 1005 (C. A. 7th, 1939), cert. den. 308 U. S. 610 (1939); *Wolf* v. *Federal Trade Commission,* 135 F. 2d 564, 566–567 (C. A. 7th, 1943).

Commerce in facilities for conducting local lotteries is within the Commission's jurisdiction.

Federal Trade Commission v. *Keppel & Brothers, Inc.,* 291 U. S. 304, 313 (1934); *Chas. A. Brewer & Sons* v. *Federal Trade Commission,* 158 F. 2d 74 (C. A. 6, 1946); *Modernistic Candies, Inc.* v. *Federal Trade Commission,* 145, F. 2d 454, 455 (C. A. 7, 1944); *Deer* v. *Federal Trade Commission,* 152 F. 2d 65, 66 (C. A. 2, 1945); *Federal Trade Commission* v. *Martoccio Co.,* 87 F. 2d 561, 564 (C. A. 8th, 1937), cert. den. 301 U. S. 691, (1937); *Maltz* v. *Sax,* 134 F. 2d 2, 5 (C. A. 7th, 1943), cert. den. 319 U. S. 772 (1943); *Chicago Silk Co.* v. *Federal Trade Commission,* 90 F. 2d 689, 691 (C. A. 7th, 1937), cert. den. 302 U. S. 753 (1937).

Powers granted to the Commission include that of eliminating lottery methods in commerce.

Federal Trade Commission v. *Keppel & Brother,* 291 U. S. 304 (1934); *Federal Trade Commission* v. *Winsted Hosiery Co.,* 258, U. S. 483, 493 (1922); *Schechter Poultry Corp.* v. *United States,* 295 U. S. 495 (1935); *Federal Trade Commission* v. *Algoma Lumber Co.,* 291 U. S. 67, 81 (1934).

Indeed the situation is such that Congress must be presumed to have had notice of the construction placed by the Commission and the courts upon the Federal Trade Commission Act as respects lottery methods and have acquiesced in and approved that construction.

Norwegian Nitrogen Products Co. v. *United States,* 288 U. S. 294, 313 (1933); *McCaughn* v. *Hershey Chocolate Co.,* 283 U. S. 488, 492–493 (1931); *Alaska Steamship Co.* v. *United States,* 290 U. S. 256, 262 (1933); *Nagle* v. *Loi Hoa,* 275 U. S. 475, 481–482 (1928); *United States* v. *Hermanos,* 209 U. S. 337, 339 (1908).

If Congress were deemed to have refrained from declaring such public policy in sufficiently broad terms, the Supreme Court had the power to declare the public policy.

United States v. *Trans-Missouri Freight Association,* 166 U. S. 290, 340 (1897); *St. Louis Mining Co.* v. *Montana Mining Co.,* 171 U. S. 650, 655 (1898); *Zeigler* v. *Illinois Trust and Savings Bank,* 245 Ill. 180, 91 N. E. 1041, 1045 (1910); *Maltz* v. *Sax,* 134 F. 2d 2 (C. C. A. 7th, 1943), cert. den. 319 U. S. 772 (1943).

The national public policy against lotteries has long been recognized by the Supreme Court.

Phalen v. *Virginia,* 49 U. S. 163 (1850); *Stone* v. *Mississippi,* 101 U. S. 814 (1879); *Federal Trade Commission* v. *Keppel & Brother,* 291 U. S. 304 (1934).

The *Keppel* case is a precedent as to the public policy authoritative herein.

Jaffe v. *Federal Trade Commission,* 139 F. 2d 112 (C. C. A. 7th, 1943), cert. den. March 27, 1944, 321 U. S. 791; *National Candy Co.* v. *Federal Trade Commission,* 104, F. 2d 999 (C. C. A. 7th, 1939), cert. den. 308 U. S. 610 (1939); *Wolf* v. *Federal Trade Commission,* 135 F. 2d 564 (C. C. A. 7th, 1943).

The remedy embodied in the order accords with law and is within the discretion granted to the Commission.

Jaffe v. *Federal Trade Commission,* 139 F. 2d 112 (C. C. A. 7th, 1943), cert. den. 321 U. S. 791 (1944); *Federal Communications Commission* v. *Pottsville Broadcasting Company,* 309 U. S. 134 (1940); *Herzfeld* v. *Federal Trade Commission,* 140 F. 2d 207, 208–209 (C. A. 2d, 1944); *Chas. A. Brewer & Sons* v. *Federal Trade Commission,* 158 F. 2d 74 (C. A. 6, 1946); *Deer* v. *Federal Trade Commission,* 152 F. 2d 65, 66 (C. A. 2, 1945); *Modernistic Candies, Inc.* v. *Federal Trade Commission,* 145 F. 2d 454, 455 (C. A. 7, 1944).

The Commission is the trier of the facts and its findings, supported by substantial evidence, are conclusive. *Federal Trade Commission* v. *Standard Education Society,* 302 U. S. 112, 117 (1937); *Federal Trade Commission* v. *Algoma Lumber Company,* 291

U. S. 67, 73 (1934); *Federal Trade Commission* v. *Pacific States Paper Trade Association,* 273 U. S. 52, 63 (1927).

The Commission's findings are presumed to be supported by substantial evidence, *Federal Trade Commission* v. *A. McLean & Son,* 84 F. 2d 910, 911 (C. A. 7, 1936).

The weight to be given to the evidence as well as the inference reasonably to be drawn therefrom is for the Commission to determine. *Corn Products Refining Co.* v. *Federal Trade Commission,* 324 U. S. 726 (1945); *Federal Trade Commission* v. *A. E. Staley Mfg. Co.,* 324 U. S. 746 (1945); *Modern Marketing Service* v. *Federal Trade Commission,* 149 F. 2d 970, 973 (C. A. 7, 1945); and the "possibility of drawing either of two inconsistent inferences from the evidence" does not prevent the Commission from drawing one of them. *National Labor Relations Board* v. *Nevada Consolidated Copper Corp.,* 316 U. S. 105, 106 (1942); *Phelps-Dodge Refining Corp.* v. *Federal Trade Commission,* 130 F. 2d 393, 395 (C. A. 2, 1943).

The Commission's findings are to be construed liberally in support of the order to cease and desist. *Allied Paper Mills* v. *Federal Trade Commission,* 168 F. 2d 600, 606 (C. A. 7, 1948), cert. den. 336 U. S. 918 (1949); *Triangle Conduit and Cable Company* v. *Federal Trade Commission,* 168 F. 2d 175, 179 (C. A. 7, 1948), aff'd, 336 U. S. 949, 956; *Rank* v. *Kuhn,* 263 Ia. 854, 20 N. W. 2d 72, and wherever from facts found other facts may be inferred which will support the order, such inferences will be deemed to have

been drawn. *Clyde Equipment Corp.* v. *Fiorito,* 16 F. 2d 106, 107 (C. A. 9, 1926).

Inferences may be drawn from obvious facts not of record. *Philadelphia Co.* v. *Securities and Exchange Commission,* 85 App. D. C. 327, 331; 177 F. 2d 720, 724 (1949).

The sale of merchandise by the use of games of chance, gift enterprises or lotteries is a practice "of the sort which the Common Law and Criminal Statutes have long deemed contrary to public policy", *Federal Trade Commission* v. *R. F. Keppel & Bro. Inc.,* 291 U. S. 304, 313 (1934); and to say that the sale of goods in interstate commerce by means of such practices is not "unfair" would be a gross perversion of the normal meaning of the word, which is the first criterion of statutory construction. See *Federal Trade Commission* v. *Royal Milling Co.,* 288 U. S. 212, 217; *Federal Trade Commission* v. *Algoma Lumber Co.* (*supra*) at 81.

While it is for the courts to determine what practices or methods of competition are to be deemed unfair, in passing on that question the determination of the Commission is of weight. The Commission was created with the avowed purpose of lodging the administrative functions committed to it in "a body especially competent to deal with them by reason of information, experience, and careful study of the business and economic conditions of the industry affected" and it was organized so as to give to its members the opportunity to acquire the expertness in dealing with those special questions concerning in-

dustry that comes from experience. See *Federal Trade Commission* v. *Beech-Nut Packing Co.,* 257 U. S. 441, 453 (1922).

It may assist the court if we first give some indication of the great body of judicial opinion which supports the Commission's actions in this matter and justifies the Commission's order.

A. The order of the Commission herein is supported by a great array of judicial precedents

We submit that the doctrines governing the Commission's order and calling for affirmance thereof are identical with doctrines laid down in lottery cases by the Supreme Court of the United States and by almost all of the Circuits. The following cases decided by the Supreme Court and by the various courts, all affirming orders of the Commission directing the discontinuance of lottery practices, we regard as clearly controlling:

> *Federal Trade Commission* v. *Keppel & Brother,* 291 U. S. 304 (1934); *Walter H. Johnson Candy Co.* v. *Federal Trade Commission,* 78 F. 2d 717 (C. A. 7th, 1935); *Lee Boyer's Candy* v. *Federal Trade Commission,* 128 F. 2d 261 (C. A. 9, 1942); *Helen Ardelle* v. *Federal Trade Commission,* 101 F. 2d 718, 719 (C. A. 9, 1939); *Deer* v. *Federal Trade Commission,* 152 F. 2d 65 (C. A. 2, 1945); *Loughran* v. *Federal Trade Commission,* 143 F. 2d 431, 434 (C. A. 8, 1944); *Wolf* v. *Federal Trade Commission,* 135 F. 2d 564, 568 (C. A. 7, 1943); *Koolish* v. *Federal Trade Commission,* 129 F. 2d 64, 65 (C. A. 7, 1942), cert. den. 317 U. S. 683 (1942);

Hill v. *Federal Trade Commission,* 124 F. 2d 104, 106 (C. A. 5, 1941); *Ostler Candy Co.* v. *Federal Trade Commission,* 106 F. 2d 962, 965 (C. A. 10, 1939), cert. den. 309 U. S. 675 (1940); *Minter* v. *Federal Trade Commission,* 102 F. 2d 69, 70 (C. A. 3, 1939); *Federal Trade Commission* v. *Winsted Hosiery Co.,* 258 U. S. 483, 494 (1922); *Perloff* v. *Federal Trade Commission,* 150 F. 2d 757, 759–760 (C. A. 3, 1945); *Chas. A. Brewer & Sons* v. *Federal Trade Commission,* 158 F. 2d 74 (C. A. 6, 1946); *Modernistic Candies, Inc.* v. *Federal Trade Commission,* 145 F. 2d 454, 455 (C. A. 7, 1944); *Jaffe* v. *Federal Trade Commission,* 139 F. 2d 112 (C. A. 7, 1943), cert. den. 321 U. S. 791 (1944); *Chicago Silk Co.* v. *Federal Trade Commission,* 90 F. 2d 689, 691 (C. A. 7, 1937); *Federal Trade Commission* v. *F. A. Martoccio Co.,* 87 F. 2d 561, 565 (C. A. 8, 1937), cert. den. 301 U. S. 691 (1937)).

In the first above-named case the Supreme Court pointed out that the lottery practice engaged in by Keppel & Bro., Inc., was "carried on by 40 or more manufacturers" and remarked that the disposition of a "large number of complaints pending before the Commission, similar to that in the present case, awaits the outcome of this suit," and continued:

> A practice so generally adopted by manufacturers necessarily affects not only competing manufacturers but the far greater number of retailers to whom they sell, and the consumers to whom the retailers sell. Thus the effects of the device are felt throughout the penny candy

> industry. A practice so widespread and so far-reaching in its consequences is of public concern if in other respects within the purview of the statute (*Federal Trade Commission* v. *Keppel & Brother,* 291 U. S. 304, 309).

Again the Court said:

> The argument that a method used by one competitor is not unfair if others may adopt it without any restriction of competition between them was rejected by this Court in *Federal Trade Commission* v. *Winsted Hosiery Co., supra;* compare *Federal Trade Commission* v. *Algoma Lumber Co., ante,* p. 67. There it was specifically held that a trader may not, by pursuing a dishonest practice, force his competitors to choose between its adoption or the loss of their trade. A method of competition which casts upon one's competitors the burden of the loss of business unless they will descend to a practice which they are under a powerful moral compulsion not to adopt, even though it is not criminal, was thought to involve the kind of unfairness at which the statute was aimed (*id.* at p. 312–313).

The doctrines of the *Keppel* case have been adopted by the various Circuits in a great variety of lottery cases under the Federal Trade Commission Act; no Circuit Court having distinguished it in the decision of any case brought before it.

In *Jaffe* v. *Federal Trade Commission,* 139 F. 2d 112 (C. C. A. 7th, 1943), cert. denied March 27, 1944, the Court said:

> We held in the *Koolish* case, *Koolish* v. *Federal Trade Commission,* 7 Cir. 129 F. 2d 64, and reiterate the ruling here, that supplying the means of conducting lotteries in the sale of merchandise is a practice contrary to the established public policy of the United States. It constitutes unfair competition in business and violates Sec. 5 (a) of the Act in question. We specifically hold that proof that sales were made because of such lottery practices is not necessary to support an order under this section (p. 112–113).

B. The doctrine of *stare decisis* as applicable to the promotion in commerce of lotteries

In the first case brought by the Commission to do away with an instance of this evil, an order was issued, in 1918, requiring the respondent in the proceeding to "cease and desist from directly or indirectly giving or offering to give to its customers or prospective customers * * * as an inducement to secure their trade * * * personal property of unequal values, the distribution of which is determined by chance or lot * * *." Matter of *Brumage-Loeb Co.,* 1. F. T. C. 159, 163 (1918). A similar early case is that of Matter of *Everybody's Mercantile Company,* 3 F. T. C. 60, 63 (1920).

There has been no real change or progression in the underlying principle that the promotion of lotteries in commerce is an unfair method of competition and against public policy.

But there has necessarily been some progression in the adaptation of remedies to reach the shifts in prac-

tice of those engaging in the promotion of lotteries in commerce and the efforts of these men to elude the grasp of the statute. Such progressions were contemplated by Congress.

In *Federal Trade Commission* v. *Beech-Nut Packing Company*, 257 U. S. 441 (1922), the Court, speaking of the term "unfair methods of competition," said:

> Congress deemed it better to leave the subject without precise definition and to have each case determined upon its own facts, owing to the multifarious means by which it is sought to effectuate such [unfair] schemes (p. 453).

The Commission was expected to follow these "multifarious means," to extirpate them, and not to be diverted by superficial modifications and pretended improvements.

In *National Candy Co. et al.* v. *Federal Trade Commission*, 104 F. 2d 999, 1005 (C. C. A. 7th, 1939), cert. den. 308 U. S. 610 (1939), the Court considered "the development of plans calculated to evade the intent of the statute, as illustrated by those here presented," and declared this "convinces us that the substitution we made [i. e., in the order of the Commission] in the *McLean* case [i. e., *Federal Trade Commission* v. *A. McLean & Son, et al.*, 84 F. 2d 910, 914] lacks effectiveness in carrying out the intention of Congress." In *Hill* v. *Federal Trade Commission*, 124 F. 2d 104 (C. C. A. 5th, 1941), a lottery case, the Fifth Circuit approved a line of cases as having closed "a loophole for evasion which is certainly closed and no more than closed, by the use of the words in con-

troversy" (106–107). And in *Wolf* v. *Federal Trade Commission,* 135 F. 2d 564, 567 (C. C. A. 7th, 1943), the Court agreed with the Commission that petitioners in that case had invoked a mere "subterfuge" to disguise the lottery character of their scheme.

State courts have often commented upon the ingenuity with which those who seek to profit by developing the gambling instinct of the public attempt to elude State laws against gaming.[2] Indeed "no sooner is a lottery defined * * * than ingenuity is at work to evolve some scheme of evasion which is within the mischief, but not quite within the letter, of the definition." *State* v. *Lipkin,* 169 N. C. 265, 84 S. E. 340, 343 (1915). The constant aim of those who live by promoting gambling schemes is "to streamline the plan with a view of concealing by name and technical operation and other fallacious pretenses one or more of the elements necessary to make it a lottery, gift enterprise, or game of chance." *State* v. *Omaha Motion Picture Exhibitors Assn.,* 139 Neb. 312, 297 N. W. 547, 550 (1941).

> In no field of reprehensible endeavor has the ingenuity of man been more exerted than in the invention of devices to comply with the let-

[2] *Troy Amusement Co.* v. *Attenweiler*, 64 Ohio App. 105, 28 N. E. 2d 207, 213–214 (1940), aff'd 137 Ohio St. 460, 30 N. E. 2d 799 (1940); *Affiliated Enterprises* v. *Waller*, 1 Terry (40 Del.), 28, 5 A. 2d 257, 259 (1939); *Cole* v. *State*, 133 Tex. Cr. R. 548, 112 S. W. 2d 725, 727 (1938); *Iris Amusement Corp.* v. *Kelly*, 366 Ill. 256, 8 N. E. 2d 648, 651 (1937); *Commonwealth* v. *Wall*, 295 Mass. 70, 3 N. E. 2d 28, 30 (1936); *State* v. *Falls Cities Amusement Co.*, 124 Ohio St. 518, 179 N. E. 405, 410 (1931); *People* v. *McPhee*, 139 Mich. 687, 103 N. W. 174, 176 (1905).

> ter, but to do violence to the spirit and thwart the beneficent objects and purposes of the laws designed to suppress the vice of gambling. Be it said to the credit of the expounders of the law that such fruits of inventive genius have been allowed by the courts to accomplish no greater result than that of demonstrating the inaccuracy and insufficiency of some of the old definitions of gambling * * * [*State* v. *Joynt,* 341 Mo. 788, 110 S. W. 2d 737, 740 (1937), following *City of Moberly* v. *Deskin,* 169 Mo. App. 672, 155 S. W. 842, 844 (1943)].

It is not surprising that the Third Circuit, in a lottery case, said:

> This case seems to us a futile continuation of earlier litigation. The trade practices of these petitioners have already been expressly condemned in a unanimous opinion of the United States Supreme Court, *Federal Trade Commission* v. *Keppel & Bro.,* 291 U. S. 304 * * *.
>
> This selling by lottery seems to have prevailed largely where it least should have prevailed, namely in the sale of penny candy to little children [*Minter Bros.* v. *Federal Trade Commission,* 102 F. 2d 69 (C. A. 3d, 1930)].

The court mentioned that in 18 cases the courts had rendered opinions and entered decrees against lottery methods under the Federal Trade Commission Act (ibid). Now there are more than 60 such decrees.

Certainly, we submit "futile continuation" of litigation would be a mild characterization today of the persistent relitigation of the promotion of lottery schemes in commerce, and it is to be regretted that

the doctrine of *stare decisis,* as respects the status of lottery promotion methods under the Federal Trade Commission Act, has not as yet proved persuasive to a substantial part of the promoters of these methods.

C. The scope of the Commission's authority is strictly limited—but the language of the Act prohibiting the use of unfair methods of competition and unfair or deceptive acts or practices in interstate commerce is subject to a broad liberal construction and not confined to fixed and unyielding categories

Relying on the *first Raladam* case and the *Bunte* case as authority petitioners contend that the Commission does not here have jurisdiction; that the holding in the *Winsted* case in reference to furnishing another with a means of violating the law is not applicable here and that the Sixth Circuit's reliance on the *Winsted* case clearly shows that the Court's decision in the *Brewer* case is wrong—from all of which petitioners conclude that applying the rule of strict construction to the words of the statute their acts and practices are not unfair, that they are not using any acts, methods or practices and that the Commision has no jurisdiction to issue the order here involved—all of which is wholly and completely devoid of merit.

We agree with petitioners that the jurisdiction of the Commission is strictly limited to unfair methods of competition and unfair or deceptive acts or practices occurring in interstate commerce and to that extent the Federal Trade Commission Act is subject to the rule of strict construction. However, when jurisdiction has been established the phrases "unfair methods of competition and unfair or deceptive acts

or practices" appearing in the Act are not subject to the rule of strict construction.

In the second *Raladam* case (*Federal Trade Commission* v. *Raladam,* 316 U. S. 149), the Supreme Court speaking through Justice Black at page 152 said:

> One of the objects of the act creating the Federal Trade Commission was to prevent potential injury by stopping unfair methods of competition in their incipiency * * *.

The practices involved in both the first and second *Raladam* cases were all prior to the amendment of the Federal Trade Commission Act, which added the words "unfair or deceptive acts or practices in commerce" to the former phrase in the Act "unfair methods of competition in commerce." This amendment makes it now unnecessary that either competition or effect on competition be shown. *Pep Boys—Manny, Moe & Jack, Inc.* v. *Federal Trade Commission,* 122 F. 2d 158, 161 (C. A. 3, 1941); *Scientific Manufacturing Co.* v. *Federal Trade Commission,* 124 F. 2d 640, 643 (C. A. 3, 1941).

In *Winsted Hosiery Co.* v. *Federal Trade Commission,* 272 Fed. 957 (C. A. 2, 1921), the court held that the use of the labels there involved was in no way connected with unfair competition and the Federal Trade Commission had no power to prohibit their use.

The Supreme Court granted certiorari and pointed out that the lower court's holding was unsound. *Federal Trade Commission* v. *Winsted Hosiery Co.,* 258 U. S. 483, 492–493 (1922).

In *Federal Trade Commission* v. *Algoma Lumber Co.,* 291 U. S. 67 (1934) the court by necessary implication rejected the doctrine that the Commission was without authority to prohibit practices "never heretofore regarded" as against the law or public policy. The court said at page 81:

> Competition may be unfair within the meaning of this statute [Federal Trade Commission Act] and within the scope of the discretionary powers conferred on the Commission though the practice condemned does not amount to fraud as understood in courts of law.

Moreover, in *Federal Trade Commission* v. *Keppel & Brother,* 291 U. S. 304, 309–310 (1934) the Supreme Court remarked that Keppel argued "that the [candy lottery] practice [was] beyond the reach of the Commission because it—

> * * * does not fall within any of the classes which this Court has held subject to the Commission's prohibition. See *Federal Trade Commission* v. *Gratz,* 253 U. S. 421, 427; *Federal Trade Commission* v. *Beech-Nut Packing Co.,* 257 U. S. 441, 453; *Federal Trade Commission* v. *Raladam Co.,* 283 U. S. 643, 652; *Federal Trade Commission* v. *Royal Milling Co.,* 288 U. S. 212, 217. But we cannot say that the Commission's jurisdiction extends only to those types of practices which happened to be litigated before this Court.
>
> "Neither the language nor the history of the Act suggests that Congress intended to confine the forbidden methods to fixed and unyielding categories.

The Supreme Court further pointed out that it was because the common law term "'unfair competition' * * * was deemed too narrow that the broader and more flexible phrase 'unfair methods of competition' was substituted" by Congress and that Congress had discarded the plan of defining "the many and variable unfair practices which prevail in commerce" and had adopted that of "a general declaration condemning unfair practices" and of leaving it "to the Commission" to determine what practices were unfair (*id.*, footnote at pp. 310–311 quoting from Senate Committee Report No. 597, 63 Cong. 2d Sess., p. 13).

Congress, in this Act, was sustained by the Supreme Court in the *Keppel* case. It was held that the result was a substantial delegation of power; and that—

> Congress, in defining the powers of the Commission thus advisedly adopted a phrase which, as this court has said, does not "admit a precise definition but the meaning and application of which must be arrived at by what this court elsewhere has called the gradual process of judicial inclusion and exclusion." *Federal Trade Commission* v. *Raladam Co.,* 283 U. S. 643.

Again, "Congress deemed it better to leave [the prohibitory powers of the Commission] without precise definition, and to have each case determined upon its own facts, owing to the multifarious means by which it is sought to effectuate such [unfair] schemes." *Federal Trade Commission* v. *Beech-Nut Packing Co.,* 257 U. S. 441, 453 (1922).

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Under this policy of Congress it is noteworthy that not only is there no specific delegation of power to the Commission to proceed against lottery methods, but there is no specific grant included in the Act to proceed against deceptive sales representations or against methods which eliminate competition or tend to create monopoly. Both the latter lines of activities have so often been held to be within the valid grasp of the Act that citation of cases would be superfluous. They would include several hundred authorities rendered by the Supreme Court and all Circuits.

The *Keppel* case recognized the same power as extending to the unfair promotion of lotteries even though this power likewise was not specifically granted.

The Supreme Court in *Schechter Poultry Corporation* v. *United States,* 295 U. S. 495 (1935), compared the constitutional delegation of powers to the Federal Trade Commission and to the Interstate Commerce Commission with the unconstitutionally attempted delegation through the National Industrial Recovery Act therein in controversy.

The Supreme Court pointed out that the sponsors of the Federal Trade Commission bill had become convinced that the term "unfair competition" as known to the common law was "too narrow" for the ends desired, and that therefore the term "unfair methods of competition" was used in the Federal Trade Commission Act. The Court declared that while the "substituted phrase has a broader meaning" which "does not admit of precise definition," the scope of that term has been "left to judicial de-

termination as controversies arise" (id. at p. 532, citing *Federal Trade Commission* v. *Raladam Co.,* 283 U. S. 643, 648, 649 and *Federal Trade Commission* v. *Keppel & Brother,* 291 U. S. 304, 310–312). This determination, the Court pointed out, was to be made "in particular instances, upon evidence, in the light of particular competitive conditions and of what is found to be a specific and substantial public interest" (id. p. 533, citing several cases, including the *Keppel* and *Algoma* cases, *supra*). The Court then pointed out that Congress had set up the Federal Trade Commission as a quasi-judicial body, to act through formal complaint, notice, hearing, findings of fact, supported by adequate evidence, and order subject to judicial review (ibid.); in contrast with the loose provisions of the Act then at bar.

The Supreme Court in the *Schechter* decision by necessary implication emphasized the opinion that the Federal Trade Commission Act was valid upon grounds distinguishing its grant of power from that attempted by the unconstitutional National Industrial Recovery Act. The opinion was unanimous.

The *Keppel* case, wherein the Supreme Court unanimously upheld the Commission's order against the sale of lotteries in interstate commerce is a controlling basic authority from which the law in reference to the Commission's authority over lotteries has been developed.

In enacting the Federal Trade Commission Act Congress delegated to the Commission jurisdiction which has been validly construed to include power, subject to judicial review, to prevent traders in com-

merce from using methods which compel competitors to lose business—perhaps face failures—unless such competitors stultify themselves by joining, in defiance of the public policy, in promoting the luring of the public into gambling habits. This was held in the *Keppel* case and was approved in the *Schechter* case.

Even if the above were not deemed fully persuasive, there are supporting doctrines of conclusive character. If there were doubt as to the intendment of the Act, its interpretation to include the prohibition of lottery methods of competition soon after organization of the Commission (see 18 orders against lottery methods in 1918, 1 F. T. C. 159, 163) and constant use of this interpretation ever since is entitled to great weight. *Edwards* v. *Darby,* 25 U. S. 207, 209 (1827); *Robertson* v. *Downing,* 127 U. S. 607, 613 (1888); *United States* v. *Healey,* 160 U. S. 136, 141 (1895); *United States* v. *Hermanos,* 209 U. S. 337, 339 (1908); *National Lead Co.* v. *United States,* 252 U. S. 140, 145 (1920).

The presumption is that Congress knew what the Commission was doing about competition through lotteries and what position the courts had taken; and acquiesced therein. *Norwegian Nitrogen Products Co.* v. *United States,* 288 U. S. 294, 313 (1933); *McCaughn* v. *Hershey Chocolate Co.,* 283 U. S. 488, 492–493 (1931).

The inference of Congress' acquiescence in administrative construction of a statute is still stronger where the legislative body has reenacted the statutory provision in question without modifying that construction. *Alaska Steamship Company* v. *United States,*

290 U. S. 256, 262 (1933); *McCaughn* v. *Hershey Chocolate Co.,* 283 U. S. 488, 492–493 (1931); *Nagle* v. *Loi Hoa,* 275 U. S. 475, 481–482 (1928); *United States* v. *Hermanos,* 209 U. S. 337, 339 (1908).

Such a legislative construction of Section 5 of the Federal Trade Commission Act is implicit in the law sometimes referred to as the Wheeler-Lea Act, amendatory of the enabling portion, Section 5, of the Federal Trade Commission Act (15 U. S. C. A. Sec. 45; 52 Stat. 111). Thereby Congress broadened, rather than restricted, the scope of said section. It added to the Commission's power to prevent the use of "unfair methods of competition in commerce" a new power, that of preventing the use of "unfair or deceptive acts or practices in commerce." It left the construction which the Commission and the courts placed upon the original section undisturbed, as respects lottery promotion as an unfair method of competition; and thus left it to the discretion of the Commission, subject to review, to decide whether said lottery promotion is also an "unfair practice." That such is its character has been the conclusion of law of the Commission in the instant case and in many lottery cases in which orders have been issued since the Wheeler-Lea Act went into effect. The court in *Wolf* v. *Federal Trade Commission,* 135 F. 2d 564, 567 (1943), cited many authorities, upheld the Commission in holding that the promotion of a lottery scheme was an "unfair practice," and declared that under the said amendatory Act, it is not necessary to show injury to competitors of petitioners (ibid.).

It, therefore, appears to us that counsel for petitioners have made improvident use of the decision in the *Raladam* case, the *Bunte* case, the *Klesner* case, and the other cases cited in their brief in a desperate effort to demonstrate that the Commission does not have jurisdiction over the sale of gambling devices in interstate commerce.

Bearing in mind the above well settled principles of law and the great body of judicial opinion by which such principles were established—showing that the Federal Trade Commission has the power to prohibit the distribution and sale of lottery devices in interstate commerce—we shall now attempt to apply those principles to the specific question here presented.

1. The Federal Trade Commission has jurisdiction to prohibit the sale and distribution in interstate commerce of punch boards and push cards designed and sold for the purpose of enabling others to sell merchandise by means of a game of chance, gift enterprise or lottery

As we have attempted to show the applicable law is well settled. The sale of merchandise by means of a game of chance, gift enterprise or lottery scheme is contrary to the public policy of the United States. Placing in the hands of others the means of engaging in acts and practices which are contrary to public policy is also a violation of the Federal Trade Commission Act.

The Federal Trade Commission has jurisdiction over practices in interstate commerce which are contrary to the public policy of the United States. *Federal Trade Commission* v. *Beech-Nut Packing Co.,* 257 U. S. 411, 453 (1922); *Kritzik* v. *Federal Trade Commission,* 125 F. 2d 351, 352 (C. A. 7, 1942);

Ostler v. *Federal Trade Commission,* 106 F. 2d 962, 965 (C. A. 10, 1939), cert. den. 309 U. S. 675 (1940).

As we read petitioners' brief, practically the entire argument and most of the authorities cited and relied upon were cases under the Federal Trade Commission Act prior to its amendment by the Wheeler-Lea Act referring specifically to unfair methods of competition. To the extent that this is true, petitioners' argument is specious. The unfair acts and practices complained of are the sale and distribution in interstate commerce of punch boards and push cards which sale or distribution, supplies to and places in the hands of others the means of engaging in unfair methods of competition and in unfair acts and practices in interstate commerce—that is, the means of distributing merchandise to the public by means of a lottery, gift enterprise or game of chance.

Section 5 of the Federal Trade Commission Act as amended (52 Stat. 111; 15 U. S. C. 45) directs the Commission to prevent persons, partnerships, or corporations "from using unfair methods of competition in [interstate] commerce and unfair or deceptive acts or practices in [interstate] commerce." In so far as the issues here raised are concerned, the complaint (Tr. R. pp. 3–15) charges only that in the sale of punch boards and push cards petitioners are engaged in unfair acts and practices in interstate commerce. There is no charge or finding of unfair methods of competition or of deceptive acts or practices in interstate commerce.

The Commission pleaded and found that the act prohibited by the order to cease and desist—the sell-

ing and distributing of lottery devices—was in interstate commerce. There is no dispute as to this. It cannot be doubted, therefore, that the acts and practices complained of and prohibited by the order occured in interstate commerce, whether they were "unfair" acts and practices or not. The sole question before this court is whether these acts and practices as committed by petitioners in interstate commerce were "unfair" within the meaning of the Federal Trade Commission Act. More simply the question is whether it is contrary to the public policy of the United States to sell lottery devices in interstate commerce when such devices are designed and sold to be used in the sale of merchandise by means of a game of chance, gift enterprise or lottery.

When the vendee of petitioners' punch boards and push cards is a dealer in interstate commerce, petitioners' acts and practices—the sales of the lottery devices—clearly place in these hands the means of selling merchandise in interstate commerce by means of a lottery device. It is well settled that such sales by petitioners' vendees are contrary to public policy and may be enjoined by the Federal Trade Commission.[3] If the purchaser of petitioners' product is a

[3] *Lee Boyer's Candy* v. *Federal Trade Commission*, 128 F. 2d 261 (C. A. 9, 1942); *Helen Ardelle* v. *Federal Trade Commission*, 101 F. 2d 718, 719 (C. A. 9, 1939); *Federal Trade Commission* v. *Keppel & Bro., Inc.*, 291 U. S. 304, 314 (1934); *Deer* v. *Federal Trade Commission*, 152 F. 2d 65 (C. A. 2, 1945); *Loughran* v. *Federal Trade Commission*, 143 F. 2d 431, 434 (C. A. 8, 1944); *Wolf* v. *Federal Trade Commission*, 135 F. 2d 564, 568 (C. A. 7, 1943); *Koolish* v. *Federal Trade Commission*, 129 F. 2d 64, 65 (C. A. 7, 1942), cert. den. 317 U. S. 683 (1942); *Hill* v. *Federal Trade Commission*, 124 F. 2d 104, 106 (C. A. 5, 1941); *Ostler*

local dealer who sells merchandise only in intrastate commerce, petitioners place in the hands of such dealers the means of selling merchandise by a game of chance, gift enterprise or lottery. There can be no doubt, therefore, that petitioners, acting in interstate commerce, not only violate the Federal Trade Commission Act but place in the hands of their customers and supply their customers with a means of violating the Federal Trade Commission Act. It is likewise well settled that to supply another with the means of violating the Federal Trade Commission Act is in itself a violation of the Act. *Federal Trade Commission* v. *Winsted Hosiery Co.,* 258 U. S. 483, 494 (1922); *Ohio Leather Co.* v. *Federal Trade Commission,* 45 F. 2d 39, 41 (C. A. 6, 1930); *Perloff* v. *Federal Trade Commission,* 150 F. 2d 757, 759–760 (C. A. 3, 1945); *Irwin* v. *Federal Trade Commission,* 143 F. 2d 316, 325 (C. A. 8, 1944); *Herzfeld* v. *Federal Trade Commission,* 140 F. 2d 207, 208 (C. A. 2, 1944) *Marietta Manufacturing Co.* v. *Federal Trade Commission,* 50 F. 2d 641, 642 (C. A. 7, 1931); *Masland Dura Leather Co.* v. *Federal Trade Commission,* 34 F. 2d 733, 736–737 (C. A. 3, 1929).

This principle has repeatedly been applied to cases in which the means supplied was a lottery device. *Deer* v. *Federal Trade Commission,* 152 F. 2d 65, 66 (C. A. 2, 1945); *Chas. A. Brewer & Sons* v. *Federal Trade Commission,* 158 F. 2d 74 (C. A. 6, 1946); *Modernistic Candies, Inc.* v. *Federal Trade Commis-*

Candy Co. v. *Federal Trade Commission*, 106 F. 2d 962, 965 (C. A. 10, 1939), cert. den. 309 U. S. 675 (1940); *Minter* v. *Federal Trade Commission*, 102 F. 2d 69, 70 (C. A. 3, 1939).

sion, 145 F. 2d 454, 455 (C. A. 7, 1944); *Jaffe* v. *Federal Trade Commission,* 139 F. 2d 112 (C. A. 7, 1943), cert. den. 321 U. S. 791 (1944); *Koolish* v. *Federal Trade Commission,* 129 F. 2d 64, 65 (C. A. 7, 1942), cert. den. 317 U. S. 683 (1942); *Bunte Bros.* v. *Federal Trade Commission,* 104 F. 2d 996, 999 (C. A. 7, 1939); *Chicago Silk Co.* v. *Federal Trade Commission,* 90 F. 2d 689, 691 (C. A. 7, 1937); *Federal Trade Commission* v. *F. A. Martoccio Co.,* 87 F. 2d 561, 565 (C. A. 8, 1937), cert. den. 301 U. S. 691 (1937). In the *Jaffe* case it was specifically held that it was not necessary to prove that sales were made with the device supplied. In the *Deer* case, speaking of lottery devices which petitioners in that case supplied to the customers upon request, the court said:

> * * * it was not necessary to prove that the petitioners actually participated in the operation of the bingo game or club plan conducted by their customers; it is enough that they aided and abetted in such methods of resale.

In all of the lottery cases cited above, except the *Modernistic* and *Brewer* cases, merchandise of some kind was provided by the various respondents which might be sold and in some cases was sold with the devices supplied. In the instant case petitioners supply nothing insofar as the issue here raised is concerned except lottery devices. That is to say, they do not supply the merchandise or prizes. This is a distinction without a difference, however, for the evil sought to be prohibited is the sale of goods by means of a lottery, not the sale of goods of any particular

person or dealer. Once the lottery device is supplied the possibility of selling goods by its use is present. The Circuit Court of Appeals for the Seventh Circuit clearly recognized this fact in *Modernistic Candies* v. *Federal Trade Commission,* 145 F. 2d 454, 455 (C. A. 7, 1944).

2. Petitioners' objections to the jurisdiction of the Commission to issue the order herein are untenable and the authorities relied upon lend it no support

Petitioners not only contend (br. pp. 11–16) that their acts are not unfair acts or practices within the intent and meaning of the Federal Trade Commission Act, because all competitors are engaged in the same practice, but they actually contend that they are not engaged in using any acts, methods, or practices in interstate commerce. The contention that the sale of punch boards or push cards in interstate commerce is not an unfair act and practice within the intent and meaning of the Federal Trade Commission Act is wholly devoid of merit and can find no support in the authorities as we have above fully demonstrated. Their contention that they are not using any acts, methods, or practices in interstate commerce is too frivolous to justify a reply.

(a) The case of *Scientific Manufacturing Co.* v. *Federal Trade Commission*, 124 F. 2d 640 (C. A. 3, 1941) is not applicable to the question here raised

Petitioners rely strongly (br. pp. 16–19) upon the *Scientific* case in support of their contention that the Federal Trade Commission has no jurisdiction in the instant matter because their acts and practices do not affect the trade in which they are engaged. This con-

tention is likewise devoid of any merit, for the *Scientific* case is easily distinguishable from the instant matter, and the decision of the Third Circuit, whether correct or incorrect, has no bearing on the issues raised. As a matter of fact, the Third Circuit itself has in a subsequent decision used language which indicates that it would not now follow the *Scientific* case on the issues here raised by petitioners. See *Perloff* v. *Federal Trade Commission,* 150 F. 2d 757 (C. A. 3, 1945) where at page 759, speaking through Circuit Judge McLaughlin, the court said: "The jurisdiction of the Commission in cases of unfair trading is recognized, regardless of whether it is the public in general, or a particular class of competitors, whose interest demands the suppression of the practice complained of." In addition to this the Circuit Courts of Appeals for the Sixth and Seventh Circuits have refused to follow the Third Circuit's decision in the *Scientific* case.

Petitioner in the *Scientific* case sold pamphlets in which he expressed his honest but erroneous opinion as to the dangers involved in the use of aluminum cooking utensils. He dealt in opinions and nothing else and sold these opinions to anyone who would buy them. Some of his pamphlets came into the hands of manufacturers and distributors of nonaluminum cooking utensils. The Commission made no finding in that case that the pamphlets were sold or placed with the manufacturers and distributors of nonaluminum cooking utensils to be used in the sale of such goods. In fact, the Commission found that the petitioner was engaged in writing and distributing

pamphlets "for sale and distribution to the public", 32 F. T. C. 493, 499 (1941), thus negativing the idea that petitioner was in the business of placing unfair methods of competition in the hands of others.

From the facts in the *Scientific* case it was clear that petitioner was not connected in any way with the cooking utensil business; had no connection with any unfair use of his pamphlets by the cooking utensil industry. There is no public policy against the expression of an honest opinion by anyone. If some take advantage of such an expression, though the opinion may be erroneous, for the purpose of committing a fraud, there is no authority which says that the author of the opinion is *particeps criminis*. It was on the fact that petitioner in the *Scientific* case was in no way connected with any business except that of selling pamphlets that the decision was rendered. The court held that the Commission could not restrain an unfair act in interstate commerce unless that act, in addition to being unfair and in interstate commerce, affected the trade in which it was perpetrated (124 F. 2d 640, 644). It, therefore, necessarily follows that if petitioners in the instant matter are engaged in a trade affected by their sale and distribution of punch boards and push cards in interstate commerce, the *Scientific* case is inapposite.

The instant matter is easily distinguishable from the *Scientific* case and presents an entirely different set of facts. The unfair act prohibited here is the sale and distribution of gambling devices "which are to be used or may be used in the sale and distribution of merchandise to the public by means of a game of

chance, gift enterprise or lottery scheme." Unlike the pamphlets in the *Scientific* case, petitioners' gambling devices are not sold to the public at large but to "manufacturers of various other articles of merchandise and to both wholesale and retail dealers in other merchandise" who use the device in selling merchandise by means of lottery to the public. This is the specific purpose for which petitoners sell their gambling devices to others.

In selling their punch boards and push cards to manufacturers and dealers, petitioners are *particeps criminis* "a criminal partner to gamblers." *Maltz* v. *Sax,* 134 F. 2d 2, 5 (C. A. 7, 1943), cert. den. 319 U. S. 772 (1943); *Modernistic Candies, Inc.* v. *Federal Trade Commission,* 145 F. 2d 454, 455 (C. A. 7, 1944); cf. *Deer* v. *Federal Trade Commission,* 152 F. 2d 65 (C. A. 2, 1945).

The sale of punch boards and push cards is so intimately connected with the sale of merchandise by means of these devices as to be inseparable therefrom. *George* v. *Wm. C. Johnson Candy Co.,* 19 Ohio App. 137, 146 (1924). It, therefore, is clear that legally petitioners are engaged in the sale of merchandise by means of lottery devices. Their business consists of selling gambling devices and merchandise, and both operations are part of one trade. Petitioners' business, consisting of selling gambling devices, is as dependent upon the sale of merchandise by means of such devices as the sale of merchandise is dependent upon the supplying of the gambling devices. Petitioners' business would collapse if their punch boards

and push cards were not used in the sale of merchandise. These are not two separate businesses, but one business consisting of two inseparably intertwined parts. The rule of *particeps criminis* applicable to petitioners should not be relaxed since the only effect of such a relaxation would be to allow petitioners to continue to violate the law and public policy, state and national. We submit, therefore, that petitioners' acts in selling punch boards and push cards in interstate commerce legally does affect the trade in which petitioners are engaged.

Further than this the *Scientific* case holds that it is sufficient if the industry is affected and if the injury is to the public. The Sixth Circuit thought the *Scientific* case could be distinguished on other grounds and, if not, refused to follow it. *Chas. A. Brewer & Sons* v. *Federal Trade Commission,* 158 F. 2d 74 (C. A. 6, 1946). In enacting the Wheeler-Lea amendment Congress only required that the act be committed in interstate commerce and that it be unfair before such act could be declared unlawful. Congress did not say that the unfairness must be to any industry—the unfairness referred to in the Act is not limited nor restricted. The primary purpose of the Federal Trade Commission Act prior to the Wheeler-Lea amendment and subsequent thereto has always been the protection of the public. Public interest may exist although the practice deemed unfair does not violate any private right. This is well established. *Federal Trade Commission* v. *Klesner,* 280 U. S. 19, 27 (1929); *Gimbel Bros.* v. *Federal*

Trade Commission, 116 F. 2d 578, 579 (C. A. 2, 1941); *Gulf Oil Corporation* v. *Federal Trade Commission,* 151 F. 2d 106, 108 (C. A. 5, 1945); cf. *Royal Baking Powder Co.* v. *Federal Trade Commission,* 281 F. 2d 744, 752 (1922). It is only necessary to show that there is an act in interstate commerce inimical to the public interest, *Progress Tailoring Co.* v. *Federal Trade Commission,* 153 F. 2d 103, 105 (C. A. 7, 1946).

(b) *Modernistic Candies, Inc., et al.* v. *Federal Trade Commission*, 145 F. 2d 454 (C. A. 7, 1944) and *Chas A. Brewer & Sons* v. *Federal Trade Commission*, 158 F. 2d 74 (C. A. 6, 1946) are squarely in point and should be followed by this court

Petitioners' analysis of the *Modernistic* case (br. pp. 27–30) is based upon a position that is untenable. They frankly tell the court that it is of vital importance to the correctness of their analysis that the court believe that *Modernistic* was engaged in the business of selling chewing gum. It follows, therefore, if *Modernistic* was not engaged in the business of selling chewing gum petitioners' analysis, argument, and conclusion fall apart.

The device which *Modernistic* supplied was a punch board of the exact type which petitioners supply, except that instead of paper being inserted in the pockets or holes *Modernistic* inserted balls of gum. Twenty or twenty-four of these balls of gum were of a different color from the other balls. If the customer punched out one of the twenty or twenty-four off-color balls he received a prize of some kind, usually a stick of candy or a candy bar. It was the merchant and not *Modernistic* who supplied the prizes.

Petitioners' analysis of this case attempts to avoid the impact of the court's decision. Petitioners claim that *Modernistic* was engaged in the business of selling gum. This is not correct and is squarely in the face of the Sixth Circuit's opinion holding to the contrary. The court treated the gum balls as a mere subterfuge, saying that the purpose of the board was *not* to sell gum. The decision, therefore, was rendered on the basis of the facts identical to those in the instant matter.

In deciding the *Modernistic* case the court stated the question presented as follows:

> The *Keppel* case, however, does not cover the case involved because the articles sold here, The Ball Gum Board, is incomplete in itself as a game of chance. No prizes are provided. The board, however, is designed, intended and conducive to gambling; its use suggests, and was intended to encourage, gambling. Our question then is whether such a method of merchandising is an unfair trade practice contrary to public policy and within the power of the Federal Trade Commission to prohibit by use of a cease and desist order where the article sold is not complete in itself for merchandising by means of a game of chance, but is so devised, planned and constructed as to encourage and induce its use for that purpose [Opinion, p. 455].

The court then held squarely that the mere supplying of the board without other merchandise was a violation of the Federal Trade Commission Act, saying that the device was too apparently allied with the

purpose of merchandising by gambling to appeal to a court as being a fair trade practice [Opinion, p. 455].

> It is clear that the Federal Trade Commission has the power to eradicate merchandising by gambling in interstate commerce. We think the Commission also has the power to prohibit the distribution in interstate commerce of devices intended to aid and encourage merchandising by gambling. The gamblers and those who deliberately and designedly aid and abet them are both engaged in practices contrary to public policy. Merchandising by gambling should not be divided into insulated acts, which appear innocent when examined separately. This unfair practice should be viewed as a whole.

This is the *ratio decendi* of the *Modernistic* case. The court continued by saying:

> If the Federal Trade Commission is to police merchandising by gambling, it must police those who designedly and deliberately aid and abet this practice.

Petitioners claim that this is dictum, but whether this last statement is dictum or not the reasoning is very cogent.

If the Commission is to stop the merchandising by lottery, it is important to *arrest the evil at its source* rather than institute separate proceedings against each of the users of the millions of punch boards and push cards which petitioners manufacture yearly. Proceedings against the manufacturers and distributors of punch boards and push cards is the only possible logical procedure for the Commission to

pursue to arrest the evil here involved—petitioners' contention to the contrary notwithstanding (Pet.'s br. pp. 41–47).

Petitioners also analyze and criticize the decision of the Sixth Circuit in *Chas. A. Brewer & Sons* v. *Federal Trade Commission,* 158 F. 2d 74 (C. A. 6, 1946), (br. pp. 19–24) including in this analysis a discussion of the various citations of authority appearing in the court's opinion. Petitioners come up with the conclusion that the Sixth Circuit was clearly wrong and that petitioners' analysis is obviously correct. There is no merit to this contention for several reasons.

In the *Brewer* case the Sixth Circuit followed the decision of the Seventh Circuit in the *Modernistic* case. In the *Brewer* case, no merchandise even in the form of subterfuge chewing gum appeared. Petitioners in that case just as in the instant matter sold punch boards and push cards without prizes or other merchandise. In the *Brewer* case as in the instant case the Commission found that the sales in interstate commerce were made to persons who make up assortments; that retail dealers used the device to sell merchandise to the public; that these intrastate sales violated the public policy of the United States; and that the respondents violated the Federal Trade Commission Act by the mere supplying of the devices. The Sixth Circuit affirmed the Commission's order holding unqualifiedly that the Commission may ban the sale of the devices alone.

Congress has given its unqualified approval to the decision of the Circuit Court in the *Brewer* case as

well as in the *Keppel* case. Public Law 906—81st Cong. (S. 3357), approved January 2, 1951, forbids the transportation of slot machines suitable for gambling in interstate commerce. Section 2 of the Act provides, however, that shipments may be made to any state which has enacted a law exempting that state from the provisions of the Act (Public Law 902—81st Cong.). Section 2 of the Act then provides:

> Nothing in this Act shall be construed to interfere with or reduce the authority or existing interpretations of the authority, of the Federal Trade Commission under the Federal Trade Commission Act as amended (15 U. S. C. 41–58).[5]

The Act, therefore, shows that in the case of punch boards and push cards it is contrary to the public policy of the United States to permit their shipment in interstate commerce even to points where their use is legal.

That this is the meaning of the Act is clearly indicated by the report of the Senate Committee on Interstate and Foreign Commerce (Senate Report No. 1482, 81st Cong. 2d sess., p. 4) where in a discussion

[5] "The long time failure of Congress to act after it had been judicially construed, and enactment by Congress of legislation which implicitly recognized the judicial construction as defective, is persuasive of legislative recommendation that the judicial construction is the correct one. This is the more so where * * * after the matter has been fully brought to the attention of the public and the Congress, the latter has not seen fit to change the Statute." *Apex Hosiery Co.* v. *Leader et al.*, 310 U. S. 469, 488 (1910).

of the above-quoted excerpt from the bill relating to the Federal Trade Commission, it is said:

> A saving clause is included in this section to avoid any misunderstanding that the Act, and particularly the proviso in Section 2 permitting unbroken transportation of gambling devices into States where their use is legal, interferes with or reduces the authority which the Federal Trade Commission has exerted under Section 5 of its constituent Act (15 U. S. C. 45) to exclude from the channels of interstate commerce devices to be used in the sale or distribution of merchandise to the public, *Federal Trade Commission* v. *R. F. Keppel & Bro., Inc.,* 291 U. S. 4; *Charles A. Brewer & Sons* v. *Federal Trade Commission,* 158 F. 2d 74.

The citations to the *Keppel* and the *Brewer* cases are part of the above quotation.

The policy in regard to gambling devices such as punch boards or push cards to be used in the sale or distribution of merchandise is thus shown to be different in this respect from the public policy in regard to devices such as slot machines which are used to gamble for money. The reason for this distinction is apparent. Slot machines could be used as a method of selling merchandise by means of a gambling device, but generally they are not so used. Punch boards and push cards are always so used and have no other purpose. The principal effect of the use of the slot machine is local. The punch boards and push cards, however, always may, and generally do cause

a diversion of trade in interstate commerce as well as in intrastate commerce. Congress is responsible for the protection of interstate commerce. It has no such responsibility in relation to intrastate gambling. It is thus seen to be the public policy of the United States not to permit the shipment in interstate commerce to any State of gambling devices customarily or ordinarily used in the sale or distribution of merchandise to the public, even if the use of the device is legal within the boundaries of the state of its destination.

The report of the House Committee on Interstate and Foreign Commerce on the same Bill (S. 3357) makes this policy doubly certain:

> Section 2 further provides that nothing in this Act shall be construed to interfere with or reduce the authority of the Federal Trade Commission under the Federal Trade Commission Act as amended. It is the purpose of this provision to leave unaffected the powers of the Federal Trade Commission with respect to the use of lotteries, games of chance, or other gambling devices for the purpose of merchandising. Such use has been held to be an unfair trade practice in violation of the Federal Trade Commission Act as amended [Report No. 2769, 81st Cong. 2d Sess. pp. 9–10].

We might here notice petitioners' reference to and reliance on *Federal Trade Commission* v. *Bunte Bros.*, 312 U. S. 349 (1941) in support of its contention that the Federal Trade Commission has no jurisdiction in the instant matter for the reason that it has no jurisdiction of intrastate commerce.

Since the decision in the *Bunte* case the Commission has not attempted to exercise jurisdiction over intrastate acts. The Commission has strictly followed the court's decision in that case and has refrained from issuing any complaints involving acts occurring wholly in intrastate commerce—even though such acts materially affected interstate commerce.

In the instant matter the Commission does not attempt to control nor does its order attempt to control any intrastate act. The order plainly, unequivocally and simply prohibits petitioners from selling their gambling devices in interstate commerce. Under this order petitioners can sell to their hearts' content wholly in intrastate commerce. Undoubtedly the order here will have an effect on intrastate commerce, since it will affect the intrastate sale of merchandise by means of lotteries. Just as the court, in the *Bunte* case, held that the mere fact that intrastate sales may affect interstate commerce did not give the Commission jurisdiction over such intrastate sales, by the same token the mere fact that the Commission's control over interstate sales may affect intrastate sales does not prevent the Commission from exercising the jurisdiction conferred upon it by the statute. The Commission's jurisdiction over interstate acts is not, however hopeful petitioners may be, ousted by the fact that the exercise of the power granted it by Congress over interstate sales may either directly or indirectly affect intrastate commerce. The *Bunte* case is not relevant to the issue here since petitioners' unlawful activities occur wholly in interstate com-

merce. Further than this, Congress has given the Federal Trade Commission power to regulate interstate commerce within the limited scope of the Act "It is no objection to the exertion of the power to regulate commerce that its exercise is attended by the same incidents which attend the exercise of the policy power of the States." *United States* v. *Darby,* 312 U. S. 100, 114 (1941). The *Bunte* case does not hold, and we find no case holding, that the Commission has no jurisdiction over acts in interstate commerce merely because such jurisdiction may affect intrastate commerce.

In view of the above, it is obvious that petitioners' interpretation of the *Scientific* case is in conflict with the facts of the decision of the Circuit Court of Appeals for the Seventh Circuit in the *Modernistic* case and with the decision of the Sixth Circuit in the *Brewer* case. Where the Circuit Courts are in disagreement we deem it proper to urge that if this court's decision is to be based on precedent, the court should follow that authority which enables the Commission to prohibit the violation of public policy involved in the sale and distribution of gambling devices in interstate commerce. Otherwise the Commission can never check the evil at its source and, therefore, can arrest the practice only from time to time in a most ineffective manner.

(c) Petitioner's arguments as to the lottery features not being part of their interstate commerce do not help them

Petitioners seem to contend that the sale of punch boards and push cards in interstate commerce as here

involved is not sale of merchandise by lottery; that the lottery method occurs in sales made in intrastate commerce over which, under the Supreme Court decision in the *Bunte* case says the Commission has no jurisdiction and therefore the public policy referred to and relied upon by the Sixth Circuit in the *Brewer* case has no application or bearing on the question here presented. This is completely devoid of either substance or merit.

It is true that the final sale to the ultimate purchaser by means of lottery of necessity, always occurs in intrastate commerce and is an intrastate transaction. The punching of the board or pushing of the card always occurs within the borders of some state. This was true in all of the lottery cases we have hereinabove cited in which the courts have held that the Federal Trade Commission had jurisdiction. Although the Commission in those cases did not prohibit the final punching of the board or pulling of the tab the Commission's order undoubtedly accomplishes that result and prevented the final intrastate sale when it prohibited the supplying of the devices and the merchandise in interstate commerce. It is petitioners who lay the foundation for these lotteries by selling their punch boards and push cards in interstate commerce.

It is also very significant that the sale of merchandise itself in interstate commerce—in so far as the record of the cited lottery cases here show—was not unlawful. The "THING" in all of those cases which made the transaction unlawful was the lottery devices. Remove lottery devices from those transactions and in

so far as the records show there was no illegal act committed. Remove the merchandise from those transactions and the "THING" remains. It is the "THING" that caused the act to be unlawful—not the merchandise—the sale and distribution in interstate commerce of punch boards and push cards to be used and designed to be used for the sale of merchandise to the purchasing public by means of a lottery scheme.

The same defense argument was offered in *Federal Trade Commission* v. *F. A. Martoccio Co.,* 87 F. 2d 561 (C. A. 8, 1937). The court held in that case that such an argument was met by the language of *Federal Trade Commisison* v. *Winsted Hosiery Co.,* 258 U. S. 483, 494, where the court held that a person is a wrongdoer who furnished another with a means of violating the Federal Trade Commission Act; and in *Chicago Silk Co.* v. *Federal Trade Commission,* 90 F. 2d 689, 691 (C. A. 7, 1937), cert. den. 302 U. S. 753 (1937), the court also held that there was no merit to such contention as petitioners originated and set in operation the scheme or device in question.

A similar case is *Koolish* v. *Federal Trade Commission,* 129 F. 2d 64, 65 (C. A. 7, 1942), cert. den. 317 U. S. 683 (1942), and in *Maltz* v. *Sax,* 134 F. 2d 2, 5 (C. A. 7, 1943), cert. den. 319 U. S. 772 (1943) in which it was held that to distinguish between the business of gambling and that of making the machine would be too great a "refinement" and that most courts have refused to make such a distinction. The

court held in the *Maltz* case that in seeking damages under the Sherman Act plaintiff did not come into court with clean hands and said "therefore, though his making and sale of punch boards may not be gambling, his status is fixed by his inseparable connection with the gambling business, and he will be left where he placed himself—not entitled to judicial assistance" (134 F. 2d at 5).

For these reasons we therefore respectfully submit that petitioners' contention under this phase of their argument is as specious as the other phases hereinabove noted.

(d) The order is not too broad and the relief afforded the public is correct and should be affirmed and enforced

Petitioners, relying on this Court's decision in *Lee Boyer's Candy* v. *Federal Trade Commission,* 128 F. 2d 261, contend that the phrase "or may be used" should be stricken from the order (br. p. 31). Again petitioners' argument is devoid of substance and the authorities relied upon give it no dignity.

In the *Lee Boyer's* case, the court held that since candy could and might be sold separate from the lottery devices, the order should be limited to the actual sale of packaged goods accompanied by such devices. Obviously this case is not in point. Petitioners here sell only lottery devices. Their devices not only "may be used" but the only purpose for which they are used and for which they are sold by petitioners, is to sell merchandise by means of a lottery device.

Further than this the determination of the type of order necessary to protect the public from business practices similar to those of petitioners rests within the sound discretion of the Commission and the courts will not disturb the Commission's orders unless they exceed the scope of the complaint or are on their face an abuse of discretion. The Supreme Court has frequently emphasized "the scope that must be allowed to the discretion and informed judgment of an expert administrative body." *Federal Security Administrator* v. *Quaker Oats Co.,* 318 U. S. 218, 227–228 (1943). The Supreme Court has also declared that the Federal Trade Commission was created with the "avowed purpose of lodging the administrative functions committed to it" in a body of experts "specially competent to deal with them." *Federal Trade Commission* v. *Keppel & Brothers,* 291 U. S. 304, 314 (1934); *Humphrey's Executor* v. *United States,* 295 U. S. 602, 621, 625 (1935). It is "not the province of the court to absorb the administrative functions to such extent that the executive or legislative agencies become mere fact-finding bodies." *Gray* v. *Powell,* 314 U. S. 402, 412 (1941). The Supreme Court has also said that in determining the propriety of a Federal Trade Commission order, great weight is given to the Commission's conclusions as being the result of an expertness coming from experience. In view of the Commission's familiarity with the problem before it, the courts should not lightly modify the Commission's order made in efforts

to safeguard a competitive economy. *Federal Trade Commission* v. *Cement Institute,* 333 U. S. 683 (1948), rehearing denied (1948).

In proceedings of this nature, the power of the courts is not administrative but judicial, and "the range of issues open to review is narrow. Only questions affecting constitutional power, statutory authority and the basic prerequisites of proof can be raised. If these legal tests are satisfied, the Commission's order becomes incontestable," and "judicial function is exhausted when there is found to be a rational basis for the conclusions approved by the administrative body." *Rochester Telephone Corp.* v. *United States,* 307 U. S. 125, 139–140, 146 (1939); *Dobson* v. *Commissioner of Internal Revenue,* 320 U. S. 489, 501 (1943).

The "relation of remedy to policy," the Supreme Court has declared, "is peculiarly a matter for administrative competence" (*Phelps-Dodge Corp* v. *National Labor Relations Board,* 313 U. S. 177), and the courts will neither "substitute their own judgment" for that of an administrative agency, *Federal Security Administrator* v. *Quaker Oats Co.,* 318 U. S. 218, 227 (1943), nor undertake to advise an agency "how to discharge its functions." *Federal Power Commission* v. *Hope Natural Gas Co.,* 320 U. S. 591, 617–618 (1944).

(e) The Commission's proceeding against petitioners is in the public interest

Without citing any authority whatever except a reference to the *Raladam* case, petitioners contend

(br. pp. 31–37) that the proceeding here is not in the public interest because the proceeding is not a direct proceeding against the sellers of merchandise in intrastate commerce by the use of their devices. There is no merit to this, and we shall not attempt a detailed reply of petitioners' contentions here.

More than 300 orders have been issued by the Commission requiring respondents to cease and desist from lottery methods in commerce. See Code of Federal Regulations of the United States—as enforced June 1, 1938—Title 16, Section 3.99, pp. 718–720; together with subsequent annual supplements of the same title and section. Of these, about 60 have been carried to the Circuit Courts of Appeals. Not one of these orders has been set aside on the merits.

The magnitude of the public interest adverse to lotteries may be understood from the diversity of the merchandise into which this insidious vice has crept.

That appeals to the public through lottery methods endanger many lines becomes evident upon mere casual inspection of the lottery cases in many recent volumes of the Federal Trade Commission and court reports. These cases show that this insidious method of selling includes ice cream cones, ice cream cup trade, blankets, clocks, tableware, kitchenware, luggage, fishing tackle, lamps, electric fixtures and numerous household articles, glassware, pen and pencil sets, radio, food mixers, electric appliances, cigarette lighters, silverwise, manicure sets, wallets, pictures, chinaware, cameras, dolls and cosmetic preparations, and in some instances, men's wearing apparel.

Bearing in mind the contagious gambling character of chance offering in selling, the efforts of the Commission and the courts to put a stop to the sale of merchandise by gambling methods take on important significance.

The strong language of the Supreme Court, in *Phelan* v. *Virginia,* 49 U. S. 163 (1850), as to the "pestilence" of lotteries which "enters every dwelling * * * reaches every class * * * and preys upon" and "plunders the ignorant and simple" applies with force many times multiplied to the spread of lottery methods into line after line of merchandise.

It is well settled that in "determining whether a proceeding is in the public interest, the Commission exercises a broad discretion," *Ford Motor Company* v. *Federal Trade Commission,* 120 F. 2d 175, 182 (C. A. 6, 1941), cert. den. 314 U. S. 668 (1941), and if a "practice is unfair within the meaning of the Act, it is equally clear that [a proceeding] aimed at suppressing it, is brought as § 5 of the Act requires, 'to the interest of the public'." *Federal Trade Commission* v. *Keppel & Brother,* 291 U. S. 304, 308 (1934); *E. D. Muller & Co.* v. *Federal Trade Commission,* 142 F. 2d 511, 520 (C. A. 6, 1944). It has been held, as we have hereinabove indicated in legions of cases involving sale by means of lotteries that such sales are in violation of the Federal Trade Commission Act and against an established policy of the United States Government and is a practice which the public has a definite and substantial interest in preventing.

We, therefore, submit that there can be no question or doubt as to the existence and cogency of the public interest which supports the order of the Commission herein and that all courts which have passed upon lottery cases have found the public interest supporting this class of cases to be not only sufficient but more than ample.

IV. CONCLUSION

We respectfully submit, therefore, that the Commission's authority to ban the shipments of punch boards and push cards without merchandise in interstate commerce is shown by (1) a long list of decisions which hold that sale of merchandise by means of games of chance, gift enterprises or lottery is against the established policy of the Government of the United States; (2) the reasoning of all decisions of the United States Supreme Court and the United States Courts of Appeals dealing with the power of the Commission to ban the sale of such devices together with the merchandise; (3) the direct holding of the Seventh Circuit and the Sixth Circuit in the *Modernistic* and *Brewer* cases respectively; and (4) by the enactment of Public Law No. 906, 81st Congress.

The Commission's order, therefore, is supported by the findings and is valid in law.

The Commission, therefore, prays that the petition to review be dismissed and that pursuant to the statute [6] the Court enter its decree affirming the Com-

[6] "To the extent that the order of the Commission is affirmed, the Court shall thereupon issue its own order commanding obedience to the terms of such order of the Commission." Federal Trade Commission Act, § 5 (c); 52 Stat. 113; 15 U. S. C. § 45 (c).

mission's order and commanding petitioners to obey and comply therewith.

Respectfully submitted.

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No. 12796

United States Court of Appeals

FOR THE NINTH CIRCUIT

BORK MANUFACTURING CO., INC., a Corporation and ALVIN BORKIN, an Individual and President of Bork Manufacturing Co., Inc.,

Petitioners,

vs.

FEDERAL TRADE COMMISSION,

Respondent.

Reply Brief and Argument for Petitioners

PETITION TO REVIEW AN ORDER OF
THE FEDERAL TRADE COMMISSION

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PETITION TO REVIEW AN ORDER OF THE FEDERAL TRADE COMMISSION

I.

THE ORDER OF THE COMMISSION IS TOO BROAD IN THAT IT RESTRAINS THE RESPONDENTS FROM SHIPPING THEIR MERCHANDISE TO PERSONS WHO ARE ENGAGED IN INTRASTATE COMMERCE AND ARE THEREFORE OUTSIDE THE ACTIVITIES WHICH THE COMMISSION IS EMPOWERED TO POLICE.

At the outset we should like to impress upon the court that our customers fall into two groups. These two groups are discussed in the Commission's brief at Pages 34 and 35 in the Bork brief. One group consists of dealers in interstate commerce. The other group consists of local dealers who sell merchandise only in intrastate commerce. The commission,

in its brief on the pages just referred to, distinguishes between these two groups, but argues that sales by us to both groups may be restrained. As to the group which consists of dealers in interstate commerce, grant for the sake of argument that the Commission has the right to restrain us from shipping our push cards and punch boards to them. As to the local dealers who sell merchandise only in intrastate commerce, we emphatically deny the power of the Commission to restrain our shipments of punch boards and push cards and we submit that the Commission is completely in error on this score because by its own theory, it claims the right to restrain us because we are alleged to "place in the hands of (our) customers and supply (our) customers with a means of violating the Federal Trade Commission Act." The *Bunte Brothers* case clearly holds that our customers who sell merchandise only in intrastate commerce are not violating the Federal Trade Commission Act. Since the theory of the Commission with respect to shipment to dealers who sell merchandise only in intrastate commerce is in direct conflict with the *Bunte Brothers* case, it necessarily follows that the order of the Commission in so far as it restrains us from shipping to customers who sell merchandise only in intrastate commerce is erroneous and the order should be at least restricted to restraining us from shipping only to dealers engaged in interstate commerce.

The following suggested order would be in conformity with the holding in the *Bunte Brothers* case:

> "* * * do forthwith cease and desist from:
>
> "Selling or distributing in commerce, as 'commerce' is defined in the Federal Trade Commission Act, punch boards, push cards, or other lottery devices to persons, firms and corporations who will pack and assemble assortments comprised of various articles of

> merchandise together with said push cards and punch board devices for shipment of said assortments in interstate commerce."

The brief for the Commission does a remarkable job of confusing the issues and in carefully avoiding an exposition of the precise bases upon which the Commission seeks an extension of its powers. The breadth of the order entered by the Commission is an unquestioned attempt to extend the powers of the Commission by seeking to exercise control over intrastate activities. The basic issue in this case is of utmost simplicity and the determination of that issue is definitely and emphatically controlled by the decision of the Supreme Court in *Federal Trade Commission v. Bunte Brothers,* 312 U. S. 351.

In the *Bunte Brothers* case, the Commission, as in the instant case, sought to broaden its powers by attempting to exercise jurisdiction and control over intrastate transactions. The Supreme Court blocked this attempted extension of power by the Commission.

Bunte Brothers was engaged in a method of merchandising candy which would clearly have been restrainable by the Federal Trade Commission if Bunte Brothers had been engaged in interstate commerce, and in fact, the company had already been restrained from using those practices in so far as it was engaged in interstate commerce. (*Bunte Brothers v. Federal Trade Commission,* 104 F. 2d 996).

In denying the power of the Commission to restrain Bunte Brothers in so far as it was engaged in intrastate commerce, the Supreme Court said (Page 351):

> "That for a quarter century the Commission has made no such claim is a powerful indication that effective enforcement of the Trade Commission Act is not dependent on control over intrastate transactions."

The court further said (Page 354):

> "The construction of §5, 15 U.S.C.A. §45, urged by the Commission would thus give a Federal agency pervasive control over myriads of local businesses in matters heretofore traditionally left to local custom or local law. Such control bears no resemblance to the strictly confined authority growing out of railroad rate discrimination. An inroad upon local conditions and local standards of such far-reaching import as is involved here, ought to await a clearer mandate from Congress."

The Commission is apparently not content to await a clear mandate from Congress, but in the instant matter, is seeking to extend its power in order to exercise control over local businesses in matters heretofore traditionally left to local custom or local law and seeks to regulate local conditions and local standards.

According to the decision in the *Bunte* case, the Commission has absolutely no power to restrain the merchandising of commodities with the use of punch boards and push cards, as long as such merchandising is in intrastate commerce. Yet the Commission has arrogated to itself the power to restrict our shipment of instrumentalities to customers who have a perfect right to use them without any interference by the Commission. The foundation upon which the Commission seeks to exercise this power is not made clear in its brief. As nearly as we can laboriously extract from the brief of the Commission, the basis for this claimed power is supposed to rest upon the power of the Commission to police the morals of the public and to restrain accessories to persons who are engaged in lottery merchandising. Neither of these grounds furnishes a basis for the Commission's claimed power because with respect to both of these bases, the Commission overlooks the element of interstate commerce.

It should be observed that the Commission cannot, as such, police the morals of the public. It is limited to operating upon "traders * * * who may * * * by pursuing a dishonest practice, force his competitors to chose between its adoption or the loss of their trade. * * * It is true that the statute does not authorize regulation which has no purpose other than that of relieving merchants from troublesome competition or of censoring the morals of businessmen." (*Federal Trade Commission v. Keppel & Bro.*, 291 U.S. 311, 313). But even in such situations where the Commission is empowered to act because of competitive practices which are deemed contrary to public policy, those competitive practices must be present in interstate transactions. This is the clear holding in the *Bunte Brothers* case which still stands as the last exposition of the law in this respect by the Supreme Court of the United States.

With respect to the other ground upon which the Commission purports to support its claim of power, namely, that it can restrain persons who contribute to activities which the Commission can restrain, again the Commission overlooks the element of interstate commerce. Those of the respondents' customers who use the punch boards and push cards of the respondents in intrastate commerce, are free to do so without any interference by the Commission. So far as the Federal Trade Commission Act is concerned, and so far as the Federal Trade Commission is concerned, those customers are not engaged in any activities condemned by the Federal Trade Commission Act. In order that the petitioners may be subjected to restraint, it is necessary to demonstrate that they are aiding and abetting persons who are violating the Federal Trade Commission Act. As to customers of the respondents who are engaged in intrastate commerce, this essential element is completely absent because those customers are not violating the Federal Trade Commission Act. *In short, the Commission seeks, in this case, to restrain the respondents from contributing to an activity which, so far as the Federal Trade Commission Act and the Federal Trade*

Commission is concerned, is perfectly lawful or at least not subject to interference by the Commission by virtue of the decision of the Supreme Court in the Bunte Brothers case.

This court in *California Rice Industry v. Federal Trade Commission,* 102 F. 2d 716, in a decision which antedated the decision by the Supreme Court in the *Bunte Brothers* case, denied the power of the Federal Trade Commission over intrastate aspects of alleged monopolies in restraint of trade. This decision by this court which finds complete confirmation by the Supreme Court in the *Bunte Brothers* case, may be sharply contrasted with the decision in *Charles A. Brewer and Sons v. Federal Trade Commission,* 158 F. 2d 74, where the court failed to recognize the essential element of interstate activity as the basis for competent Commission restraint. It is true that the court in the *Brewer* case attempts to distinguish the *Bunte Brothers* case, but we submit that the attempted distinction is not sufficiently precise in that there is no differentiation made by the court with respect to two different classes of customers, namely, those who are engaged in interstate merchandising and those who are engaged in intrastate merchandising. The principle upon which the Brewer decision rests itself destroys the supposed distinction between the situation existing in the *Brewer* case and that existing in the *Bunte Brothers* case. The court in the *Brewer* case rested its decision upon the principle "that a person is a wrongdoer who so furnishes another with the means of consummating a fraud has long been a part of the law of unfair competition."

More specifically stated with respect to the field in which this case arises, the court held (Page 77):

> "For the reasons hereinafter appearing, we have reached the conclusion that, in thus aiding and abetting, inducing and procuring manufacturers and wholesale and retail dealers in merchandise to use unfair or deceptive acts or practices and unfair methods of

competition, Charles A. Brewer & Son, though manufacturing no merchandise except the lottery device which they had shipped in interstate commerce, fall within the restraining power of the Federal Trade Commission as vested by the Federal Trade Commission Act."

The foregoing is a rather unfortunate expression of the conclusion of the court because it lumps together all of the customers of Charles A. Brewer & Son without distinguishing between those who use the lottery devices in interstate activities and those who use them in intrastate activities. The first group is, of course, composed of violators of the Federal Trade Commission Act. The second group is not subject to the interdiction of the Federal Trade Commission Act. Brewer & Son were using no unfair or deceptive acts or practices or unfair method of competition. The only basis upon which the court justified restraining shipments by Brewer & Son was that Brewer & Son were supposed to be aiding and abetting others to use unfair or deceptive acts or practices. Yet it has been held in the *Bunte* case that intrastate merchandising by lottery is not using unfair or deceptive acts or practices. How then can the decision in the *Brewer* case be justified in so far as it sustains the restraint upon shipment to customers engaged only in intrastate merchandising? Such conclusion is in direct conflict with the decision in the *Bunte Brothers* case and in the *California Rice Industry* case. Even granting *arguendo* that the principle enunciated in the *Brewer* case, that aiding and abetting an act violative of the Federal Trade Commission Act justifies restraint of the aider or abetter, the conclusion reached by the court is thoroughly unjustified because of the complete absence of the primary act violative of the Federal Trade Commission Act, in the case where customers are engaged in intrastate commerce. As to those customers the situation might be regarded as analogous to charging one with being

an accessory to a crime when, in fact, no crime had ever been committed.

We submit the possibility that the court in the Brewer decision in reaching its broad and indiscriminate conclusion, was led astray by the unfortunate reasoning in *Modernistic Candies v. Federal Trade Commission,* 145 F. 2d 454, 455. A quotation from the last cited case appears at Page 78 of the Brewer decision.

In the *Modernistic Candies* case, the court said:

> "It is clear that the Federal Trade Commission has the power to arrogate merchandise by gambling in interstate commerce."

This is an accurate statement of the law because it includes the vital element that the merchandising be in interstate commerce. The court however, continues:

> "We think the Commission also has the power to prohibit the distribution in interstate commerce of devices intended to aid and encourage merchandising by gambling. The gamblers and those who deliberately and designedly aid and abet them are both engaged in practices contrary to public policy."

Here the court again states the law too broadly because it fails to include the element of interstate commerce. Merchandising by gambling is cognizable by the Federal Trade Commission only when it is present in interstate commerce. If it is present in intrastate commerce, the *Bunte Brothers* case holds it is not restrainable by the Federal Trade Commission. Therefore only those who aid and abet merchandisers by gambling in interstate commerce can possibly fall within the restraints of the Federal Trade Commission Act. The confusion of the court in the *Modernistic Candies* case is further demonstrated by their statement, "if the Federal

Trade Commission is to police merchandising by gambling, it must police those who designedly aid and abet this practice." The Supreme Court in the *Bunte Brothers* case has squarely held that it is not the function of the Federal Trade Commission to police merchandising by gambling where the merchandiser is engaged in intrastate commerce. Again, the Circuit Court of Appeals in the *Modernistic Candies* case has overlooked the essential element of intrastate commerce and has given expression to a too comprehensive scope and character of the policing function of the Federal Trade Commission.

Our position finds confirmation in the complaint filed in the instant case. Apparently, the Commission initially had a more accurate conception of the elements which had to be present in order to restrain the petitioners. In paragraph 1 of the complaint (Tr. 4) it was alleged:

> "Respondents are now and for more than three years last past have been engaged in the manufacture of devices commonly known as push cards and punch boards, and in the sale and distribution of said devices to manufacturers of and dealers in various articles of merchandise *in commerce between and among the various states of the United States, and in the District of Columbia.*" (Italics ours.)

It is apparent that the Commission felt, and properly so, that it was necessary to allege that the customers of the respondents were engaged in interstate commerce. In paragraph 3 of the complaint (Tr. 6) the Commission in the same vein, becomes more specific and alleges:

> "Many persons, firms and corporations who sell and distribute, and have sold and distributed, candy, cigarettes, clocks, razors, cosmetics, clothing and other articles of merchandise *in commerce between and among the various States of the United States and in*

> *the District of Columbia,* purchase and have purchased petitioners' said push card and punch board devices * * *." (Italics ours.)

The concluding allegation of paragraph 4 is most enlightening as to the Commission's conception of the essential element of the charge (Tr. 7):

> "The respondents thus supply to, and place in the hands of, said persons, firms and corporations the means of, and instrumentalities for, engaging (in) unfair acts and practices within the intent and meaning of the Federal Trade Commission Act."

Under the *Bunte Brothers* case and the *California Rice Industry* case, the only persons, firms and corporations who could be guilty of unfair acts and practices within the intent and meaning of the Federal Trade Commission Act, would be those who are engaged in merchandising in interstate commerce, and accordingly, the charge in the complaint accurately and precisely levels the only plausible criticism against the respondents who are charged with supplying the devices to persons, firms and corporations who are engaging in unfair acts and practices within the intent and meaning of the Federal Trade Commission Act. *But the order entered by the Commission goes beyond this charge and restrains the supplying of the device to all customers and not merely those who are violating the Federal Trade Commission Act.* Apparently, during the course of the proceeding, the Commission acquired an exaggerated concept of its power and gave itself relief greater than that sought in its own complaint. Aside from the substantial significance of the variance between the complaint and order, as a procedure matter the variance invalidates the order. See *Federal Trade Commission v. Goatz,* 253 U.S. 421, where the court said at page 427:

> "Such an order shall follow the complaint; otherwise it is improvident, and, when challenged, will be annulled by the court."

We do not propose to answer the Commission's brief *seriatim*. We believe it will be sufficient to point out that the theory of the Commission is fundamentally fallacious because it fails to embrace the criterion of interstate character of the merchandising by lottery. This is clearly indicated by the Commission's brief at Page 10 in which they formulate their conception of the two basic fundamental principles which undoubtedly are the principles upon which the Commission rests its entire case. The first principle, as stated by the Commission, is:

> "The sale of goods by a plan or method which involves the use of a game of chance, gift enterprise, or lottery is a practice which is contrary to an established policy of the Government of the United States and is an unfair method of competition and an unfair act and practice in violation of the Federal Trade Commission Act."

It is impossible to frame a clearer contradiction of the holding in the *Bunte Brothers* case. The failure to include the element of interstate character renders this supposed principle hopelessly deficient. Yet, the order of the Commission necessarily rests upon the principle exactly as formulated on Page 10 of the Commission's brief. Both the principle as stated and the order of the Commission fail to take into account that the *Bunte Brothers* decision renders the Commission powerless to interfere with merchandising by lottery in intrastate commerce.

The second principle upon which the Commission rests its order is thus stated at Page 10 of the Commission's brief:

> "Supplying to or placing in the hands of others the means or methods of conducting a game of chance,

> gift enterprise, or lottery in the sale and distribution of merchandise is an unfair method of competition and an unfair act and practice in violation of the Federal Trade Commission Act."

This statement not only begs the question in the case, but is also inaccurate for exactly the same reasons which invalidate the first principle hereinabove discussed at length.

Throughout the brief of the Commission we find a repitition of the error which crept into the initial statement of fundamental principles by the Commission, namely, the nonchalant discard of the one element regarded as vital by the Supreme Court in the *Bunte Brothers* case—the element of interstate commerce.

Throughout the Commission's brief the hobgoblins of gambling and public policy are raised in an effort to frighten this court into sustaining the Commission's order. The fate of the morals of the whole nation supposedly hinges on the action of this court. The Commission paints itself as a crusader devoted to the specific task of eradicating the use of punch boards and push cards throughout the United States thereby rescuing the American public from this evil. The short answer to this emotional appeal to the court's understandable prejudice against gambling is that the Supreme Court of the United States in the *Bunte Brothers* case has squarely held that the Commission can legitimately operate only within the limited sphere of influence circumscribed by the Federal Trade Commission Act. The Supreme Court has held that merchandising by lottery in intrastate commerce does not fall within the sphere of influence of the Federal Trade Commission. Any broadening of this sphere must be by Congress and not by the Commission.

The action of Congress in connection with gambling activities is most significant, but that significance is distorted by the Commission in its brief. (*Bork* Brief, particularly at Pages 45 to 48). In the legislation discussed by the Com-

mission, Congress has followed the recommendation of the Supreme Court and has specifically excluded certain gambling devices, namely, slot machines, from interstate traffic. Significantly enough, Congress has not seen fit to include a specific prohibition against shipping push cards and punch boards within the prohibition. Fundamental logic compels the conclusion that where Congress specially legislates with respect to certain gambling devices and fails to legislate against punch boards and push cards, it is obviously the legislative intent not to cover the latter. While it is true that the report of the House Committee on Interstate and Foreign Commerce refers to the use of lotteries, games of chance, or other gambling devices for the purpose of merchandising as an unfair trade practice, that reference must be construed in the light of the decision in the *Bunte* case and we must necessarily refer to the use of lotteries, etc. for the purpose of merchandising in interstate commerce. The use of lotteries for the purpose of merchandising in intrastate commerce has been held by the Supreme Court not to violate the Federal Trade Commission Act. Knowing that, Congress has still not seen fit to prohibit the shipment of punch boards and push cards in interstate commerce. Congress is still content to leave in effect the powers of the Federal Trade Commission as defined in the *Bunte* case. That is to say, the powers of the Federal Trade Commission are still confined to merchandising by lottery in interstate commerce and the Commission possesses no power over merchandising by lottery in intrastate commerce. By the same token that the United States public policy permits shipments of slot machines to any state which has enacted a law exempting that state from the provisions of the Slot Machine Act, the public policy of the United States, if that has any bearing on the case, should be regarded as permitting the shipment of push cards and punch boards to any customer for use in a manner not violative of the Federal Trade Commission Act.

II.

THE ENTIRE ORDER OF THE COMMISSION IS IMPROPER BECAUSE IT DOES NOT RESTRAIN THE RESPONDENTS FROM USING ANY UNFAIR METHOD OR PRACTICE RELATING TO COMPETITIVE ACTIVITIES BUT BROADLY RESTRAINS THE SHIPMENT OF MERCHANDISE AS SUCH.

At times peculiar circumstances of cases and extensive litigation in a field of law resulting in decisions wherein courts adopt unfortunate expressions of prior decisions, results in a clouding of fundamental concepts formulated by the legislature. We submit that this situation has developed in the field of law arising under the Federal Trade Commission Act. We submit that the time has come for the courts to revert to first principles. These first principles are contained in the Federal Trade Commission Act which declares:

> "Unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce are hereby declared unlawful."

The act further provides (Section 5):

> "The Commission is hereby empowered and directed to prevent persons, partnerships, or corporations, * * * from *using* unfair methods of competition in commerce and unfair or deceptive acts or practices in commerce." (Italics ours.)

It should be observed that the power of the Commission is directed to prevent persons from *using* certain condemned methods and acts or practices. As a matter of fundamental common sense, the person charged with violating the act must be guilty of using a method or act or practice which is unfair. The sale of any commodity as a sale can never be restrained. It is only the sale accompanied by the use of an unfair method or practice which is condemned by the Act.

The court in *Scientific Manufacturing Co. v. Federal Trade Commission,* 124 F. 2d 640, did not allow itself to be diverted from first principles. In that case the Commission restrained the publication and sale of pamphlets which the Commission found were false, misleading and disparaging of utensils made of aluminum. In view of the fact that these pamphlets were false, misleading and disparaging they could hardly be regarded as innocent instrumentalities. Yet the court denied the power of the Commission to restrain the publication and sale of these pamphlets on the theory that the publishing company was not using an unfair method or act or practice. The court did not regard it as important that the pamphlets were used by competitors of sellers of aluminum utensils and that the use of the pamphlets provided an unfair competitive advantage to those exploiting the pamphlet. The Commission could restrain the use of these pamphlets unfairly by merchandisers, but were powerless to prevent the publication and sale of the pamphlet by Scientific Manufacturing Company. This is a correct and forthright stand consistent with the dictates of the Federal Trade Commission Act and is far sounder than the decisions in the *Modernistic Candies* case and the *Brewer* case wherein the courts departed from fundamental principles and recognized power in the Commission to restrain mere contributors to persons using an unfair method or practice. There is nothing in the Federal Trade Commission Act which speaks of aiding or abetting or contributing to unfair methods or practices. While superficially this contributory unfair practice doctrine would appear to have an appeal to justice, its unsoundness is demonstrated by the facts in the *Scientific Manufacturing Company* case. Certainly, Scientific Manufacturing Company was aiding and abetting an unfair practice within the meaning of the Federal Trade Commission Act. But the application of that doctrine to the facts in that case appeared so outrageous to the court that it repudiated the existence of that doctrine. This repudiation was required by the clear language of the

Federal Trade Commission Act. Implicit in that act is the concept of user.

In the case at bar the furnishings of the push cards and punch boards to persons who use them in connection with merchandising is no different from the supplying of pamphlets to be used by persons in merchandising kitchen utensils.

The Commission invokes the rule of *particeps criminis* as applicable in a situation where a contributor to an unfair method or practice is sought to be restrained. However, the Commission has been sorely put to square this doctrine with the decision in the *Scientific* case. They labor mightily on Pages 37 to 40 of the *Bork* brief to distinguish the *Scientific* case from the case at bar with respect to the application of the doctrine of *particeps criminis*. The supposed distinction completely escapes us.

The inescapable fact is that in both the *Scientific* case and in the case at bar, the respondents are engaged in the manufacture and sale of items for sale to the public generally. A portion of the public engaged in the sale of merchandise in interstate commerce in both the *Scientific* case and in the case at bar, make use respectively of the Scientific pamphlets and of our push cards and punch boards under circumstances which violate the Federal Trade Commission Act. The cases are distinguished from each other and if the *Scientific Company* was not subject to restraint on the theory of *particeps criminis*, then neither are we. Furthermore, as we have effectively demonstrated in our proceeding point, as to those of our customers which use our punch boards and push cards for merchandising in intrastate commerce, they are not violating the Federal Trade Commission Act and obviously the doctrine of *particeps criminis* cannot possibly apply.

The Commission in its brief (*Bork* Brief, Pages 11 to 13) seeks to create the impression that a legion of cases support the validity of the Commission's order, support the doctrine that commerce in facilities for conducting local lotteries is within the Commission's jurisdiction, and that powers granted

to the Commission include that of eliminating lottery methods in commerce. Examination of these cases discloses that in all of these cases with the exception of the *Modernistic Candies* and *Brewer* cases, the situations involved restraint of the merchandiser himself who was using a lottery method. The only two cases announcing the theory of violation by contribution are the *Modernistic Candies* case and the *Brewer case.* In the *Modernistic* case, the court stated that the *Keppel* case, which is representative of all of the other cases, was inapplicable to the case of a mere contributor as distinguished from one actually using a lottery method of merchandising. On Page 42 of its *Bork* brief, the Commission affirms our comment on all of the cases cited by the Commission by holding forth only two cases as being squarely in point, namely, the *Modernistic Candies* case and the *Brewer* case. These are in fact the only two cases which cover the situation in the case at bar. We have heretofore fully disected the reasoning of the courts in these two cases to demonstrate the unsoundness of the holding therein and we shall not at this point again burden the court with further criticism of these decisions.

CONCLUSION

Our position in the matter is twofold: We first contend that the entire order of the Commission should be set aside; we alternately contend that at least the order should be modified because in its present form it is too broad.

We respectfully submit that the entire order of the Commission is vulnerable because it is founded upon an unsound doctrine of contributory violation. This doctrine finds no support in the basic act and has been repudiated by a soundly reasoned opinion in the *Scientific* case. The entire order should be set aside for this reason.

Alternately, we submit that even if the doctrine of contributory violation were applicable, the order is still too broad because it prohibits shipment of instrumentalities to persons who will not be violating the Federal Trade Commission Act

by using them. Those persons are engaged in intrastate commerce and according to the decision in the *Bunte Brothers* case and the *California Rice Industry* case, they are not within the interdiction of the Federal Trade Commission Act.

In order to obviate the foregoing unanswerable objection to excessive scope, the order should in any event be modified to read as follows::

> "* * * do forthwith cease and desist from:
>
> "Selling or distributing in commerce, as 'commerce' is defined in the Federal Trade Commission Act, punch boards push cards, or other lottery devices to persons, firms and corporations who will pack and assemble assortments comprised of various articles of merchandise together with said push cards and punch board devices for shipment of said assortments in interstate commerce."

Respectfully submitted,

Of Counsel:
GEORGE E. LINDELOF, JR.,
215 West Seventh Street,
Los Angeles, Calif.

F. W. JAMES
9488 Drake Ave.,
Evanston, Ill.,
Attorney for Petitioners.

No. 12,796

United States Court of Appeals

FOR THE NINTH CIRCUIT

BORK MANUFACTURING CO., INC., A Corporation, and ALVIN BORKIN, an Individual and President of Bork Manufacturing Co., Inc.,

Petitioners,

vs.

FEDERAL TRADE COMMISSION,

Respondent.

Petition for Rehearing

PETITION TO REVIEW AN ORDER OF THE FEDERAL TRADE COMMISSION

F. W. James,
9448 Drake Ave.,
Evanston, Ill.
Attorney for Petitioners.

FILED

FEB 25 1952

PAUL P. O'BRIEN

United States Court of Appeals
FOR THE NINTH CIRCUIT

No. 12,796

BORK MANUFACTURING CO., INC., A Corporation, and ALVIN BORKIN, an Individual and President of Bork Manufacturing Co., Inc., Petitioners,

vs.

FEDERAL TRADE COMMISSION, Respondent.

PETITION TO REVIEW AN ORDER OF THE FEDERAL TRADE COMMISSION

Come now the above named petitioners and respectfully petition the Court for a rehearing hereof for the following reasons.

Petition for Rehearing

I.

One of petitioners points is that the only acts and practices within the jurisdiction of the Federal Trade Commission are acts and practices which are either unfair to competitors, consumers, or both. To sustain this proposition the petitioners as part of their argument on this point cited the testimony of the late Commissioner Davis given before the committee. This testimony showed clearly that the only purpose of the Wheeler Lea Amendment was to give the commission additional jurisdiction to protect the consumer. On this point, the opinion herein refers to the history of the act and in a footnote sets out some of the comments made by the author of the amendment, Mr. Lea. In the footnote it is said:

> "Indeed, the principle of the act is carried further to protect the consumer as well as the competitior. In practice the main feature will be to relieve the commission of this burden, but we go further and afford

> a protection to the consumers of the country that they have not heretofore enjoyed."

And Senator Wheeler as set out in the same footnote stated:

> "This amendment makes the consumer who may be injured by an unfair trade practice of equal concern before the law with the merchant injured by the unfair methods of a dishonest competitor."

The review of the history of Section 5 (a) substantiates petitioner's contention that the only acts and practices which are within the jurisdiction of the Federal Trade Commission are acts and practices which are either unfair to competitors, consumers or both.

It is self-evident and the commission admits that the acts and practices complained of in this proceedings are not unfair to competitors or consumers. Therefore, petitioners conduct is not within the purview of the Federal Trade Commission Act and because of this the order issued herein should be set aside.

II.

Neither the case of Charles A. Brewer and Sons vs. Federal Trade Commission, 158 F. 2d 74, nor the Globe Cardboard Novelty Company case were decided upon the basis that the practices herein involved were unfair to competitors or consumers. Both cases were predicated upon the erroneous assumption that the intrastate use of punch boards is within the Federal Trade Commission Act. It is fundamental as both opinions are predicated upon this assumption that if the assumption is erroneous then the decisions are also erroneous. The assumption is without question erroneous because the Supreme Court has so held. In other words, these two cases have overruled the Supreme Court.

III.

It is the petitioners contention that what may have been said concerning Public Law 906, 81st Cong., 2d Sess., ap-

proved January 2, 1951, forbidding the transportation of slot machines has no bearing upon the power given to the Federal Trade Commission. Had the Bunte case been taken into consideration at the time, undoubtedly those remarks would not have been made. What the Supreme Court says certainly should have more authority than what the 6th Circuit says. When the Supreme Court construed the Federal Trade Commission Act remarks in a congressional report or statement by members of Congress cannot override the Supreme Courts ruling. Petitioners position is that the saving clause of the slot machine act must be interputed in the light of the holding by the Supreme Court in the Bunte case.

IV.

Petitioners failed to clearly present to this court their contention concerning the public interest. The opinion herein states:

> "Petitioner further urges that the prevention of the use of its gambling devices in the sale of merchandise to the ultimate consumer is not in the public interest."

This is not our contention at all. Our contention is that it is not to the public interest as that expression is used in the Federal Trade Commission Act to issue a cease and desist order against petitioners shipping punch boards in interstate commerce. Our reasons are as follows: The stopping of the interstate shipment of punch boards will not in any degree minimize the distribution of merchandise by lotteries. Because punch boards are not the only devices used for this purpose so that if the use of all punch boards is eliminated the distribution of merchandise by lotteries would go on unabated. Furthermore, practically every state in the Union has some form of a punch board or push card factory, the local factories furnish all the punch boards needed. It seems to the petitioners that it is obvious that the public are not interested in the Federal Government spending all the money it is spending in proceedings of this type when the only result is that petitioners are stopped from shipping of punch

boards in interstate commerce which has absolutely no effect on the use of lotteries to distribute merchandise.

V.

Petitioner's wish to again press their point that the order issued herein is broader than the complaint, therefore the order must be modified in such manner as will bring it within the limited allegations of the complaint. On this point, the Supreme Court has held, in the case of Federal Trade Commission vs Gratz, 253 U. S. 421, 427 40 S ct, 572, 574, 64 L ed 993, "The things which may be prohibited is the method of competition specified in the complaint. Such an order should *follow the complaint*; otherwise, it is improvident, and, when challenged will be annulled by the court."

The complaint alleges that:

> "Petitioners supplies to, and places in the hands of persons, firms and corporations the means of and instrumentalities for, engaging in unfair acts and the practices within the intent and meaning of the Federal Trade Commission Act." (Rec. 22)

Under the principle of law set out by the Supreme Court in the Gratz case, supra; the order should be modified to read as follows:

> The petitioners are ordered to cease and desist from placing in the hands of persons, firms and corporations the means of and instrumentalities for engaging in unfair acts and practices within the intent and meaning of the Federal Trade Commission Act.

Respectfully submitted,

F. W. JAMES,
Attorney for petitioners

CERTIFICATE

Comes now the undersigned attorney for petitioners herein and hereby certifies that in his judgment this Petition is well founded and is not interposed for delay.

F. W. JAMES

No. 12801

United States
COURT OF APPEALS
for the Ninth Circuit

M AND M WOOD WORKING COMPANY,
Petitioner,

vs.

FEDERAL TRADE COMMISSION,
Respondent.

On Petition to Set Aside Cease and Desist Order of Federal Trade Commission.

BRIEF FOR PETITIONER

SABIN AND MALARKEY,
ROBERT L. SABIN,
HOWARD H. CAMPBELL,
Attorneys for Petitioners.

STEVENS-NESS LAW PUB. CO., PORTLAND 7-51

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No. 12801

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Respondent.

On Petition to Set Aside Cease and Desist Order of Federal Trade Commission.

BRIEF FOR PETITIONER

JURISDICTION OF THIS COURT

This cause concerns the review of an order of the Federal Trade Commission, of which this Court was granted jurisdiction by 15 U.S.C.A., Sec. 45(c).

The Federal Trade Commission began the proceedings by issuing its complaint (R. 3) on February 26, 1948. On August 8, 1949, the Commission issued an

amended complaint (R. 35). On August 23, 1949, this petitioner filed its answer (R. 54) to the amended complaint.

No evidence, other than the pleadings, was offered or received by the Trial Examiner, and the proceedings before him were closed on September 30, 1949 (R. 77).

On October 20, 1950, the Commission made certain findings of fact and conclusions (R. 78) and issued an order (R. 94) directing the petitioner and others to cease and desist from certain practices therein specified. On November 6, 1950, the petitioner was served with a copy of the findings of fact, conclusions and order, which were a final decision by the Commission.

Pursuant to 15 U.S.C.A., Sec. 45(c), this petitioner, on December 29, 1950, filed in this Court a written petition (R. 133), praying that the order of the Commission be set aside. It served the Commission (R. 136) with a copy of the petition, and the Commission forthwith certified and filed in this Court a transcript of the entire record.

Both the petition (R. 133) and the Commission's findings (R. 78) recite that this petitioner is an Oregon corporation; that its principal place of business is in Oregon; and that it does business in the States of Oregon, Washington and California. All of the acts, practices and methods of competition, which were used by the petitioner and to which the Commission had reference in its findings, conclusions and order, occurred in one or more of those three states.

STATEMENT OF THE CASE

During a substantial part of the period between January, 1938, and November, 1941, this petitioner and some other members of the door industry had an agreement in restraint of trade.

There is no evidence relating to or concerning the period of more than six years between November, 1941, and the issuance of the original complaint on February 26, 1948, or any period of time subsequent thereto.

Neither this petitioner nor any of the other members of the industry offered any evidence that they had discontinued their unlawful activities.

The Commission offered no evidence that the petitioner or others had continued their unlawful activities. At the argument before the Commission, its attention was called to certain telegrams terminating certain patent license agreements. An unresolved dispute arose as to whether those license agreements were illegal. No showing was made that the agreements were being used. The most claimed by counsel for the Commission was that they might have given the Commission reasonable cause to make an investigation. There was no showing that the Commission deemed the termination of the agreements reasonable cause to make an investigation or that the Commission made an investigation. All we know is that the Commission offered no evidence, if it had any; that it did not reopen the proceedings or start a new proceeding.

As a result, the gap of ten years must be filled with a substitute for evidence. Commissioner Mason thought (R. 102) that proof of an unlawful activity in 1915, without more, would justify a cease and desist order in 1951. In other words, it is reasonable to infer from the fact that this petitioner was committing unlawful acts prior to 1941 that it was committing the same acts in 1950—or that it was likely that it would commit the acts after 1950. This petitioner argues that the inferences are unreasonable and that a cease and desist order based thereon is such an arbitrary exercise of the Commission's authority that it should be set aside.

The question, therefore, is whether the Commission had any reasonable basis to infer, from the fact that unlawful activities occurred prior to 1941, that unlawful events were occurring in 1950 or were likely to occur after 1950.

SPECIFICATIONS OF ERRORS

There is only one question in this case. It was raised by two separate specifications of error stated in this petitioner's points (R. 142-143), as follows:

"I.

"The Federal Trade Commission erred in finding, in Paragraph Nine of its Findings of Fact dated October 20, 1950, that the capacity, tendency and results of an understanding, agreement, combination, conspiracy and planned common course of action, and the acts and things done thereunder and pursuant thereto 'now are'

as set forth in said findings, because there was no evidence offered or received that such understanding, agreement, combination, conspiracy and planned common course of action, or the acts and things done thereunder and pursuant thereto, existed or occurred, or were threatened or likely to exist or occur, or had any capacity, tendency or results or other continuing effect, at any time after November 29, 1941.

"II.

"The Federal Trade Commission erred in issuing the cease and desist order dated October 20, 1950, or any cease and desist order, because there was no evidence offered or received that an understanding, agreement, combination, conspiracy and planned common course of action, or the acts and things done thereunder and pursuant thereto existed, occurred, or were threatened or likely to exist or occur, or had any tendency, capacity or results or other continuing effect, at any time after November 29, 1941. Due to the long lapse of time between November 29, 1941, and the initiation of proceedings by the respondent on February 26, 1948, no cease and desist order of any kind should have been issued."

ARGUMENT

The essence of the petitioner's objection to the Commission's findings and order is that there is not reasonable cause for imposing upon the door industry an enforcement order, with its penalties of contempt and

action for damages. The possibility of unlawful conduct at some unknown time in the future is not great enough to warrant the imposition of a club.

The Commission's primary function is to stop unlawful methods of competition before they have their undesirable results. It must, therefore, concern itself with prophecies of future events and it has been given a wide discretion in making its expert decisions as to the probability of future conduct. See *Galter v. Federal Trade Commission,* 186 F. (2d) 810 (CA 7, 1951). Conversely, it may not exercise its discretion in an unreasonable or arbitrary manner. If it makes a decision based upon evidence or a substitute therefor with which reasonable men could not agree, its decision will be reversed.

This case seems to involve a conflict of presumptions. There being no evidence in the record after 1941, the Commission seems to rely upon a presumption that unlawful activity, once shown, continues. This petitioner and other members of the industry seem to rely upon a presumption of change—that a condition existing more than ten years ago must have been changed, if it has not been completely abandoned.

This petitioner denied that any unlawful activity or the threat thereof existed after 1941 (R. 54). With this knowledge, the Commission failed to proceed, and presented no evidence either of a continuance or of a threat to continue, but chose rather to rely upon an abstract inference. In view of the uncontested denial of the petitioner and the long lapse of time, with its conse-

quent natural changes, especially those created by a war, subsequent inflation and the threat of a new war, an inference of continuance or threat thereof is clearly unreasonable.

A cease and desist order, like an injunction, should only be used when there is a real and substantial threat of the continuance or occurrence of unlawful activity. *Federal Trade Commission v. Civil Service Training Bureau,* 79 F. (2d) 113 (CCA 6, 1935); *L. B. Silver Co. v. Federal Trade Commission,* 292 Fed. 752 (CCA 6). There is no such threat in this case. The most that the Commission can say now—or could say in 1948 when the original complaint was filed, or in 1950 when the findings and order were made—is that at some unknown time in the future the economic conditions may be such and the circumstances of the door industry may be such that this petitioner and other members of the industry may violate the law and at that time it would be convenient to have an enforcement order hanging over its head. Convenience to the Commission does not constitute a threat nor is it a lawful cause to justify its control of an industry by injunction.

Respectfully submitted,

SABIN AND MALARKEY,
ROBERT L. SABIN,
HOWARD H. CAMPBELL,
Attorneys for Petitioner.

No. 12803

United States
Court of Appeals
for the Ninth Circuit.

FRED C. HALL,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Transcript of Record

Petition to Review a Decision of the Tax Court of the United States

FILED
MAR 7 1951
PAUL P. O'BRIEN,
CLERK

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.

No. 12803

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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APPEARANCES

ELI FREED, ESQ.,
For Petitioner.

T. M. MATHER, ESQ.,
For Respondent.

The Tax Court of the United States
Docket No. 21027

FRED C. HALL,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

1948

Nov. 23—Petition received and filed. Taxpayer notified. Fee paid.

Nov. 24—Copy of petition served on General Counsel.

Nov. 23—Request for Circuit hearing in San Francisco filed by taxpayer. 12/10/48 Granted.

Dec. 22—Answer filed by General Counsel.

Dec. 22—Request for hearing in San Francisco filed by General Counsel.

Dec. 23—Copy of answer and request served on taxpayer. San Francisco.

1949

Sept. 9—Hearing set November 7, 1949—San Francisco calendar.

Nov. 7—Hearing had before Judge Harron on Merits. Briefs due 12/22/49. Replies 1/26/50.

1949

Dec. 7—Transcript of hearing 11/7/49—Filed.

Dec. 9—Brief filed by General Counsel. Copy served 12/21/49.

Dec. 21—Brief filed by taxpayer. Copy served 12/21/49.

1950

Jan. 11—Reply brief filed by General Counsel. Copy served.

Jan. 25—Reply brief filed by taxpayer. Copy served.

Aug. 31—Findings of fact and opinion rendered, Judge Harron. Decision will be entered for respondent. Copy served.

Aug. 31—Decision entered. Judge Harron, Div. 13.

Nov. 24—Stipulation of venue filed.

Nov. 24—Petition for review by U. S. Court of Appeals, 9th Circuit, with assignments of error filed by taxpayer.

Nov. 24—Notice of filing petition for review filed by taxpayer.

Nov. 24—Designation of contents of record on review filed by taxpaper.

Nov. 24—Affidavit of service by mail of petition for review, notice of filing petition for review and designation of record filed.

Nov. 27—Proof of service of petition for review filed.

The Tax Court of the United States
Docket No. 21027

FRED C. HALL,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION

The above named petitioner hereby petitions for a redetermination of the deficiencies set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau Symbols IRA:90-D:WBH (C:TS:PD SF:ORM) dated October 26, 1948, and as a basis of his proceeding alleges as follows:

1. The petitioner is an individual whose present residence is Oakland, California, and whose address for purposes herein is c/o Freed, Gebauer & Freed, 1069 Mills Building, San Francisco 4, California. The returns for the periods involved herein were filed with the Collector of the 18th District of Ohio.

2. The notice of deficiency (a copy of which is attached and marked Exhibit "A") was mailed to the petitioner October 26, 1948.

3. The taxes in controversy are income and victory taxes for the taxable year ended December 31, 1943, in the sum of $614.96, and income taxes for the taxable year ended December 31, 1944, in the sum of $952.67.

4. The determination of taxes set forth in said

notice of deficiency is based upon the following errors:

(a) The Commissioner erred in holding that the sum of $5,000.00, representing the fair market value of 50 shares of stock of the Ohio Aircraft Fixture Company received by petitioner in 1942, was not income realized by petitioner in 1942 but should be divided and allocated one-half or $2,500.00 to the year 1943 and one-half or $2,500.00 to 1944 and taxable in such years accordingly.

(b) The Commissioner erred in holding that a certain agreement in writing (a copy of which is attached hereto and marked Exhibit "B") entitled "Employment Contract," made November 25, 1942, between Ohio Aircraft Fixture Company and Fred C. Hall, the petitioner herein, provides that the 50 shares of stock of the Ohio Aircraft Fixture Company to be received by petitioner as provided in paragraph 5 of such agreement, was not realized by him as income at the time of the issue of said stock and the deposit thereof with the treasurer of the company in 1942, but was income to petitioner when delivered to him by the treasurer of the company as therein provided, viz., 25 shares on December 1, 1943, and 25 shares on December 1, 1944.

5. The facts on which the petitioner relies as the basis of this proceeding are included in and controlled by the agreement aforesaid (Exhibit "B" attached hereto), together with the facts that the two certificates aforesaid for 25 shares each were issued to petitioner and delivered to him and endorsed in blank by him and deposited by him with the

treasurer of the company in 1942 as security for his faithful performance. Thereafter and in accordance with petitioner's faithful performance of said contract, one certificate for 25 shares of stock was released from deposit by the treasurer aforesaid and delivered to petitioner December 1, 1943, and the other certificate for 25 shares of stock was released by the treasurer and delivered to petitioner December 1, 1944.

Wherefore, the petitioner prays that this Court may hear the proceeding and determine that there are no deficiencies in income and victory taxes for the taxable year ended December 31, 1943 and income tax for the taxable year ended December 31, 1944.

/s/ ELI FREED,
Counsel for Petitioner.

State of California,
County of Alameda—ss.

Fred C. Hall, being duly sworn, says that he is the petitioner above named; that he has read the foregoing petition or had the same read to him, and is familiar with the statements contained therein, and that the statements contained therein are true, except those stated to be upon information and belief, and that those he believes to be true.

/s/ FRED C. HALL.

Subscribed and sworn to before me this 13th day of November, 1948.

[Seal] /s/ ANDRO J. MACHO,
Notary Public in and for the County of Alameda, State of California.

My commission expires Aug. 3, 1951.

Received and filed T.C.U.S. November 23, 1948.

Served November 24, 1948.

[Title of Tax Court and Cause.]

ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed by the above-named petitioner admits and denies as follows:

1, 2 and 3. Admits the allegations contained in paragraphs 1, 2 and 3 of the petition.

4 and 4(a) and (b). Denies that the Commissioner erred in the determination of the deficiencies as alleged in paragraph 4 of the petition and subparagraphs (a) and (b) thereunder.

5. Admits that one certificate for 25 shares of stock was delivered to petitioner December 1, 1943, and the other certificate for 25 shares of stock was delivered to petitioner December 1, 1944, but denies

the remaining allegations contained in paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioner's appeal denied.

/s/ CHARLES OLIPHANT,
Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:
B. H. NEBLETT,
Division Counsel;

T. M. MATHER,
Special Attorney,
Bureau of Internal Revenue.

Received and filed T.C.U.S. December 22, 1948.

The Tax Court of the United States
Docket No. 21027

FRED C. HALL,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Met, pursuant to notice, at 4:30 o'clock p.m.

Before: Hon. Marion J. Harron, Judge.

Appearances:

ELI FREED,

1609 Mills Building,
San Francisco, California,
Appearing on behalf of the Petitioner.

T. M. MATHER,
(Hon. Charles Oliphant, Chief Counsel, Bureau of Internal Revenue)
Appearing for the Respondent.

PROCEEDINGS

The Clerk: I will call next Docket No. 21027, Fred C. Hall.

Please state your appearances, gentlemen, for the record.

Mr. Freed: Eli Freed, appearing for the Petitioner.

Mr. Mather: T. M. Mather, for Respondent.

The Court: Mr. Freed, would you please proceed.

Opening Statement on Behalf of Petitioner

By Mr. Freed:

Mr. Freed: I would like to make a short opening statement.

The issue, as I see it, in this matter is a very simple one. It concerns whether or not 50 shares of the capital stock of an Ohio corporation, Ohio Aircraft Fixture Company, issued in 1942 to Fred C. Hall, the taxpayer, and pursuant to a written employment contract which was made by him in the Ohio Aircraft Fixture Company in November, 1942, was income in 1942, taxable income in 1942, or income in the following two years on the basis of 25 shares of such stock which were released to him in December of 1943 and 25 shares of stock released to him by the Company in December of 1944.

The contract, written contract, which is the basis for the disposition, as I see it, of this issue, has in it Paragraph 5, which provides: The first party; that is, the [3*] Ohio Aircraft Fixture Company, shall issue 50 shares of stock of the company in consideration of the signing of this employment contract and to carry out certain contracts necessary in the prosecution of the war. Two certificates are to be issued, each to be for 25 shares, and endorsed in blank. They are to be deposited with the Treasurer of the company for the faithful performance of this contract, one certificate for 25 shares to be delivered on December 1st, 1943, and the other certificate for

*** Page numbering appearing at top of page of original Reporter's Transcript of Record.**

25 shares to be delivered on December 1st, 1944, on the order of the Board of Directors.

Our position is that those shares were issued to Fred C. Hall at or about the time he signed the employment contract in 1942, that he became the owner of them, entited to all the rights of an owner, and that he had the obligation of depositing those shares of stock with the Treasurer of the company as a guarantee or surety for the performance, and the income was taxable, based upon the fair market value of those shares that was realized in 1942.

The Court: Is there any question about the amount of the income that was realized?

Mr. Mather: I don't know of any question.

The Court: That is, the amount of the income would be the fair market value of the stock?

Mr. Freed: There seems to be no controversy regarding the fair market value. [4]

Mr. Mather: None whatever.

The Court: All right. Mr. Mather?

Opening Statement on Behalf of Respondent

By Mr. Mather:

Mr. Mather: It is the position of the Respondent, if your Honor please, that this was income to the Petitioner on the receipts and disbursements basis in the year that the certificates were received in '43 and '44.

The Court: On the theory that that would be the earliest time in which he would have dominion and control over the certificates and the proceeds that could be realized from them?

Mr. Mather: Although the contract provides that

he is to receive the certificates, he is not to receive them under the contract until '43 and '44, and at that time it was income to him.

The Court: Have you stipulated to that?

Mr. Freed: No, we have not, but I just talked to Mr. Mather and it appears there seems to be no material dispute on the facts. Is that correct?

Mr. Mather: None that I know of.

The Court: Are any of the facts set forth in the Petition admitted?

Mr. Mather: Some of them are admitted. The contract isn't admitted but I will stipulate that Exhibit B, referred [5] to in Paragraph 5, attached to the Petition, is a copy of the contract.

Mr. Freed: Yes.

Mr. Mather: And then it is admitted that one certificate for 25 shares of stock was delivered to the Petitioner on December 1, 1943, and the other certificate for 25 shares of stock was delivered to the Petitioner on December 1, 1944.

Mr. Freed: Will it be stipulated that the two certificates of stock were given to Mr. Hall, the taxpayer, at or about the time he signed the contract, issued in his name, and that thereafter he endorsed the certificates and deposited them with the Treasurer of the Ohio Aircraft Fixture Company; that is, in 1942?

Mr. Mather: It will be stipulated that the contract of Exhibit B, referred to and attached to the stipulation, was carried out, and that provides for the issuance of the stock to Mr. Hall and his en-

dorsement in blank and being returned, and that that was done.

Mr. Freed: In '42?

Mr. Mather: In '42.

Mr. Freed: I think we probably have the case right there.

The Court: Are you going to offer any exhibits, Mr. Freed? [6]

Mr. Freed: Just the contract, I believe.

The Court: The contract is received in evidence as Petitioner's Exhibit 1.

(Whereupon the document was marked for identification as Petitioner's Exhibit 1 and was received in evidence.)

PETITIONER'S EXHIBIT No. 1

Employment Contract

This Agreement made at Cleveland, Ohio, this 25th day of November, 1942, by and between Ohio Aircraft Fixture Company, an Ohio corporation, of Cleveland, Ohio, hereinafter called "First Party" and Fred C. Hall of Cleveland, Ohio, hereinafter called "Second Party."

Witnesseth:

The Parties hereto mutually agree as follows:

1. That the First Party [the Company] hereby hires the Second Party [petitioner] and the Second Party agrees to work for First Party in the capacity of Manager of the Service Engineering Department, in charge and responsible for all sales

and advertising, formulating and figuring all selling prices in co-operation with the shop engineering and cost departments and to assist the factory manager in scheduling and planning production in First Party's business of general manufacturing, particularly aircraft, jigs and fixtures for a period of two (2) years, commencing on the 15th day of November, 1942, and ending on the 14th day of November, 1944.

2. Said Second Party shall at all times during such term of employment give his full attendance and to his best endeavors and to the utmost of his skill and abilities exert himself for the profit, benefit and advantage of said business and perform such duties in said capacities as shall be required of him from time to time by First Party.

3. First Party shall pay the Second Party for his services hereunder as salary and compensation at the rate of One Hundred and Twenty-five ($125.00) per week in addition to ten per cent (10%) of the profits over $5,000.00 before Federal Taxes and after providing for all known reserves for contingencies; of the salary $100.00 is to be paid in cash each week, $25.00 and the said ten per cent, at the option of the Directors of the Company, may be paid in cash or in stock of the Company and shall be payable on or before January 15th of each year and shall cover the preceding year.

4. It is agreed by and between the parties that in case of illness, the base salary shall continue at full rate for six (6) months, half rate for a consecutive six (6) months and quarter rate for the

balance of the term of the contract in excess of two six months periods, the additional salary, if any remaining the same. First Party through its Boards of Directors, if it deems advisable, may demand Certificate of Inability to perform on account of illness from one or more reputable physicians.

5. First Party shall issue fifty (50) shares of stock of the Company in consideration of the signing of this employment contract and to carry out certain contracts necessary in the prosecution of the war. Two certificates are to be issued. Each to be for twenty-five shares and endorsed in blank. They are to be deposited with the Treasurer of the Company for the faithful performance of this contract. One certificate for twenty-five shares to be delivered on December 1, 1943 and the other certificate for twenty-five shares to be delivered on December 1, 1944, on the order of the Board of Directors.

6. Second Party agrees that during the life of this contract he will not engage in any manner either directly or indirectly engage in any other gainful occupation without consent of the Board of Directors; and shall further be directly responsible to the Board of Directors of the Company for the operation of his departments and said Directors shall from time to time determine the operating policies of these departments.

7. It is agreed by and between the parties that this contract will be considered performed on death of the Second Party.

In Witness Whereof, The First Party has caused its corporate seal to be hereunto affixed and its cor-

porate signature attached by H. H. Warnsman, Secretary, and B. P. Fortney, President, and Second Party has hereunto set his hand as of the date and year first above written.

OHIO AIRCRAFT FIXTURE COMPANY,

[Seal] By /s/ H. H. WARNSMAN,
Secretary,

By /s/ B. P. FORTNEY,
President,
First Party.

/s/ FRED C. HALL,
Second Party.

Signed in the presence of:
/s/ F. E. POTTING,

/s/ T. J. COOK.

Admitted November 7, 1949.

Mr. Freed: If you want some background, I have Mr. Hall here.

The Court: Well, since there is no objection to the authenticity of the contract, you may offer it at this time and it can be received in evidence.

The Clerk: Exhibit 1.

The Court: Now if you want to call Mr. Hall, you may call him at this time.

Whereupon,

FRED C. HALL

was called as a witness on behalf of the Petitioner and having been first duly sworn, testified as follows:

The Clerk: State your name and address.

The Witness: Fred C. Hall, 10975 Elvessa Avenue, Oakland.

Direct Examination

By Mr. Freed:

Q. Now, Mr. Hall, you were a resident of Cleveland, Ohio, in 1942, to and including 1945, were you not? [7] A. Yes.

Q. You worked with the American Coach and Body Company, an Ohio corporation, in Cleveland, Ohio, immediately preceding November, 1942, did you not? A. Yes.

Q. And what was your position with the company?

A. I managed the Jig & Fixture Division for the American Coach and Body Company.

Q. Now, prior to and during the month of November, 1942, you associated yourself with some men in Cleveland, Ohio, for the purpose of forming the Ohio Aircraft Fixture Company, did you not?

A. Yes.

Q. What was the purpose of the organization of that company? What did it undertake to do?

A. To purchase the Jig & Fixture Division of the American Coach and Body Company.

(Testimony of Fred C. Hall.)

Q. Did you give up your employment with the American Coach and Body Company to become an officer, director and employee of the Ohio Aircraft Fixture Company in November, 1942?

A. Yes.

Q. I show you Petitioner's Exhibit 1, which is in evidence, entitled "Employment Contract," and that is the contract which you entered into with the Ohio Aircraft Fixture Company, is it not? [8]

A. Yes.

Q. Now, this employment contract in Paragraph 5 thereof refers to 50 shares of the stock, of the capital stock, of the Ohio Aircraft Fixture Company to be issued to you in the form of two certificates of 25 shares each in consideration of the signing of that contract, and it goes on and says, "and to carry out certain contracts necessary for the prosecution of the war." When did you first see those certificates for 25 shares each?

A. When they were handed to me by Mr. Warnsman.

Q. And Mr. Warnsman was an officer of the Ohio Aircraft Fixture Company? A. Yes.

Q. And that was in the latter part of 1942?

A. Yes, it was.

Q. And did you examine those certificates at that time? A. I did.

Q. And did they disclose the fact that they were issued in your name, each of them? A. Yes.

Q. That is, both of them and each was for 25 shares of stock? A. Yes.

(Testimony of Fred C. Hall.)

Q. Then what did you do with those certificates?

A. I examined them and endorsed them and gave them to [9] Mr. Fortney.

Q. And he was an officer of that corporation?

A. He was.

Q. That is, the Ohio Aircraft Fixture Company. And you began working for that Company November 15, 1942? A. Yes, I did.

Q. And when were those certificates returned to you?

A. One certificate was returned late in 1943 and another in 1944, late in the year.

Q. And when the second certificate was returned to you, were you working for that company?

A. Yes, I was.

Q. Did you continue to work for that company thereafter? A. I did.

Q. And you worked for them until some time in September, was it, of 1945? A. Yes.

Q. And then you sold your shares of stock at that time? A. Yes, I did.

Q. How much did you sell those shares of stock for? A. $150 each share.

Mr. Freed: No further questions.

Mr. Mather: No cross-examination.

Mr. Freed: That is all.

The Court: I might want to ask the witness a question or [10] two.

How many stockholders were there of the Ohio Aircraft Fixture Company?

The Witness: There were five stockholders.

(Testimony of Fred C. Hall.)

The Court: How much stock was issued?

The Witness: Equal amounts were issued to three stockholders, Mr. Warnsman, Mr. Fortney, and myself.

The Court: In a total amount of how many shares?

The Witness: Originally, the three of us—let's see. There were four, Mr. Wilson also. 231 shares originally.

The Court: Do I understand you to mean that out of a total of 231 shares you were to receive 50 shares and the other three gentlemen were to receive 50 shares?

The Witness: 50 shares each, yes.

The Court: That would be 200 shares.

The Witness: 200 shares.

The Court: What were the other 31 shares for?

The Witness: The other three gentlemen each purchased ten shares at the time of organization and I purchased one share.

The Court: Was an employment contract executed by the other three stockholders?

The Witness: Yes.

The Court: And then all of you turned back your stock to the Secretary of the Company, or to someone, to the [11] Treasurer of the Company?

The Witness: Yes. That clause was uniform in all of the contracts.

The Court: Why was that done?

The Witness: That was to be a bond that we would faithfully perform the contracts.

(Testimony of Fred C. Hall.)

The Court: What contracts?

The Witness: The contracts to serve the company for a two year period, as stipulated in each contract.

The Court: It is an unusual kind of contract arrangement, because ordinarily when a new company is organized and stock is issued, it is issued for capital, and if 200 shares out of 231 shares were issued as compensation for services, it would mean that only 31 shares were issued for capital. It is hard to understand. I wonder if there is any explanation for that.

The Witness: May I explain. This new management was taking over a going concern and the only immediate problems were to supply enough operating capital to take care of the current demands. There were valuable contracts involved that we knew should be profitable and they later proved to be profitable, and tools and machinery were purchased from the American Coach and Body Company on very lenient terms and even the personnel was transferred over from the American Coach and Body Company to carry the business on. [12]

The Court: That is, you had war contracts or contracts with the Government that were to be performed?

The Witness: Yes.

The Court: And were those supposed to be the source of the capital requirements, the payments under those production contracts?

The Witness: Well, we intended to accumulate some capital as we went along, from that source.

(Testimony of Fred C. Hall.)

The Court: Why was this stock issued to you in addition to binding your agreement to give your services to the organization? Why was the stock issued to you?

The Witness: As an incentive to me to leave the place I had been employed for a six-year period and take the responsibility of completing the contracts that were taken over with the business.

The Court: Was that supposed to be a monetary inducement?

The Witness: I would say so, yes.

The Court: Well, in this agreement, no value is ascribed to the shares of stock. Did the stock have a par value?

The Witness: The value was established. It was a no par stock. The value was established by the directors.

The Court: When?

The Witness: At the first stockholders'—at [13] the first shareholders' meeting.

The Court: Was that in 1942, about the time this agreement was executed, the agreement of November 25, 1942?

The Witness: About that time, yes. I would say right in there.

The Court: What was the value that was ascribed to the capital stock?

The Witness: $100 per share.

The Court: Then am I to understand that when this 50 shares of stock was issued to you, you had an understanding that that had a value of $5,000?

The Witness: Yes, that is right.

(Testimony of Fred C. Hall.)

The Court: Now, you say that you ultimately disposed of this stock and you stated what you disposed of it for. What did you dispose of it for?

The Witness: $150 per share.

The Court: $150 per share?

The Witness: Yes.

The Court: $50 more per share than the value that was ascribed to it?

The Witness: Yes.

The Court: I don't know whether all these questions are strictly material, counsel, but I have started a line of questions and it leads me to a few others, so if you have any objection to any of these questions, please feel free to object. [14] Have you any objection?

Mr. Freed: None yet.

The Court: I started to ask you who bought the stock from you? I don't know whether it is material or not.

The Witness: Mr. Warnsman and Mr. Fortney.

The Court: Is this company still in existence?

The Witness: No, it is not.

The Court: The question in this case, Mr. Hall, appears to turn upon the construction of the clause in the contract, and while you are here and in the court room, I will ask you to look at Paragraph 5 of that employment agreement. That is an agreement that you signed and I expect you understood the agreement when you signed it, so perhaps you can tell the Court what your understanding of that agreement was.

(Testimony of Fred C. Hall.)

The Witness: Yes.

The Court: May I have the Exhibit 1, Mr. Baird.

We don't have the shares of stock here but I assume the two certificates for 50 shares were issued in your name?

The Witness: Yes.

The Court: Now, the contract says that the certificates were to be issued "each to be for 25 shares and endorsed in blank." It doesn't say endorsed in blank by whom and it doesn't say to be issued to whom. What does that mean?

The Witness: They were issued to me and they were [15] endorsed by me.

The Court: How long was this employment contract supposed to extend?

The Witness: Two years, two years from November 15, 1942.

The Court: Do you have any idea about what the purpose of this clause was, that is set forth in Paragraph 5?

The Witness: I will give you my understanding of it.

The Court: Very well.

The Witness: Prior to signing the contract it was agreed that I was to receive 50 shares of stock for signing the contract and then I was to endorse the stock certificates back to the officer of the company that was prescribed, and the purpose of my signing the contract was to enable the company to carry out certain important contracts we were

(Testimony of Fred C. Hall.)

taking over to furnish aircraft tools, jigs, and fixtures to the Curtiss Wright Corporation in St. Louis and to the newly-organized Aircraft Division of the Firestone Tire & Rubber Company. That is where they refer to "and to carry out certain contracts necessary in the prosecution of the war." That was my understanding and is my understanding of the entire matter.

The Court: What is your understanding of the provision that required you to endorse the certificates and [16] return them to the Treasurer of the Company?

The Witness: Well, I would believe that if I failed to perform under the contract, owing to the responsibility that the company had to complete those contracts I would need to be replaced, and if there were expense or damages involved in replacing me or because I didn't complete the contract, those damages could be recovered from the value of the stock that they were holding that had been issued to me.

The Court: That is all.

Mr. Freed: No questions.

Cross-Examination

By Mr. Mather :

Q. Mr. Hall, you didn't pay anything for this stock other than this employment agreement?

A. I paid no money for it at that time.

Q. And it was because of your services in con-

(Testimony of Fred C. Hall.)

nection with the company that you received the compensation provided in this employment agreement and also the stock?

A. The compensation is outlined, I believe, in the contract, and those were for my services. It refers specifically to rate of pay in the contract.

Q. Well, there were similar contracts with the Secretary and President, Warnsman and Fortney, were there not? A. Yes.

Q. For similar amounts of stock? [17]

A. Yes.

Q. And they were to perform services also for the Company? A. Yes.

Mr. Mather: That is all.

The Court: I believe the witness has testified, Mr. Mather, that the stock was issued to him as the consideration for his signing the contract. Now, there may be some question about whether the stock itself was compensation for services. That would be a question of fact, I believe, and not a question of interpretation of the contract. I realize that the case is really submitted for decision upon the basis of this contract and that the Court will be asked to construe the contract.

Well, it is a simple contract and although the contract ought to speak for itself, if it doesn't, anything else ought to be covered, ought to be established by evidence. It would be a matter of fact, and it would be a matter of proof and that is why the Court asked the witness a few more questions. If

(Testimony of Fred C. Hall.)
there is anything else that you can establish by the testimony of this witness, please do so.

Mr. Freed: I would like to make a comment that might lead somewhere. Some of your Honor's questions were directed to the idea of what capital stock was supplied to this company. [18]

The Court: Those were exploratory questions.

Mr. Freed: Yes. I, of course, had the same curiosity when it first came to me, and Mr. Hall's testimony in response to those questions, as I understand it, is that the company had certain valuable contracts and that they were taking over a going business, and seeing that there was no issue as to fair market value involved, it would seem to me that that could be looked to only for the purpose of interpretation or construction of the contract. It has nothing to do whatsoever with the contribution of capital by the stockholders for the shares of stock.

The Court: You understand that with the limited acquaintance I have with the situation, I just wanted to eliminate certain things by asking those questions. Some of them are not material but it gives a little better understanding of what the situation was.

Now, this contract states in Paragraph 3 that the party of the second part, who is Mr. Hall, the Petitioner in this case, is to receive a salary, and the salary is fixed at $125 a week in addition to ten per cent of the profits over $5,000. That is supposed to state what the compensation of the company was

(Testimony of Fred C. Hall.)

to this taxpayer for his services to the company. Is there anything further?

Mr. Mather: I might just ask one question.

Q. The Board of Directors did make and order for the [19] delivery of the stock to you, as provided in Paragraph 5, did it not, at or about the time the stock was delivered?

A. It was delivered to me in accordance with the contract, the terms of the contract.

Q. Yes, which provided that one certificate for 25 shares was to be delivered on December 1, 1943, and the other certificate for 25 shares to be delivered on December 1, 1944, on order of the Board of Directors? A. It was returned, yes.

Q. Pursuant to that? A. Yes.

Mr. Mather: That is all.

The Court: Well, now I believe I have one more question.

Did you report this item for income tax purposes in some return?

The Witness: Yes, in 1942.

The Court: What did you report in your income for 1942?

The Witness: The salary I had drawn prior to this plus the $5,000 stock value.

Mr. Freed: Do you have the return, Mr. Mather, for '42?

The Court: Is that true, that the taxpayer did report this for income in '42? [20]

Mr. Freed: We can put the return in evidence, your Honor.

(Testimony of Fred C. Hall.)

The Court: As I understand it, the Commissioner added $5,000 to income for '43 and $5,000 to——

Mr. Freed: $2,500.

The Court: What did you say?

Mr. Freed: The Commissioner eliminated the $5,000 income attributable to stock for 1942 and added $2,500 attributable to that stock to his income in 1943 and $2,500 is added to his income in 1944.

The Court: Well, in the statement attached to the notice of deficiency on Page 4 it is said that the fair market value of 25 shares of stock of the Ohio Aircraft Company "received as compensation" represents income in the taxable year 1943, and the same explanation is given on Page 6, the other adjustment for income for 1943—just strike that. I have to find out what the trouble is. I have located what was giving me some concern.

Q. (By Mr. Mather): Now, Mr. Hall, do you know what your salary was from the Ohio Aircraft Fixture Company in 1942?

A. That was the year we started. I can't name the figure, no.

Q. Well, would $9,691.50 refresh your recollection to any extent?

A. Well, I believe that is about the [21] figure that was reported, yes, sir.

Q. And it was about the same in '43 and '44, was it? A. I believe it would be, yes.

Q. Now, can you tell me where the $5,000 for stock is in that return for '42?

(Testimony of Fred C. Hall.)

A. It was reported as income.

Q. Well, is it in that $9,000?

A. Yes. It is in there.

Q. That is all you got, is $5,000 worth of stock, which is included in the $9,000? A. Yes, sir.

Q. Now, in 1943 what was your salary, do you recall? About the same as it was in '42?

A. It was in accordance with the employment contract.

Q. There was no difference in the rate of compensation in '42 and '43 under the employment contract, was there?

A. Well, we only worked under the employment contract about six weeks in '42.

Q. According to the return, it was $10,015 in '43.

A. That would sound about right.

Q. And $9,793.54 in '44?

A. Yes. I think these figures that are shown here should be about it, yes, sir.

Mr. Mather: That is all.

Mr. Freed: No questions. [22]

The Court: Thank you very much, Mr. Hall, for giving us your testimony.

(Witness excused.)

The Court: Do both parties rest at this time?

Mr. Mather: Yes.

Mr. Freed: Yes.

The Court: The briefs in this case will be due

(Testimony of Fred C. Hall.)

December 22, 1949, and the reply briefs will be due January 26, 1950.

This proceeding now stands submitted.

(Whereupon, at 5:05 o'clock p.m., the hearing in the above-entitled matter was concluded.) [23]

Certificate

I, Franklin R. Greene, one of the official reporters of the Tax Court of the United States under its reporting contract, assigned to report certain proceedings during the session of The Tax Court in San Francisco, California, beginning November 7, 1949, do hereby Certify as follows:

That I reported all of the proceedings in the case of Fred C. Hall, Docket No. 21027 on November 7, 1949, before the Honorable Marion J. Harron, Judge of The Tax Court;

That I did well and truly, to the best of my ability, record in Stenotypy fully, completely and accurately all of the proceedings which I was assigned to report, including all colloquy and statements made during the proceedings, and all questions to and answers given by witnesses;

That my stenotype record is full, complete and accurate; and

That the foregoing record is a true, complete and accurate transcript of my stenotype notes of all the proceedings which I reported, and all of the testi-

mony which was taken in the above-entitled cause.

/s/ FRANKLIN R. GREENE.

Date: Nov. 23, 1949.

Filed T.C.U.S. December 7, 1949. [24]

The Tax Court of the United States
Docket No. 21027
15 T. C. No. 30

FRED C. HALL,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Promulgated August 31, 1950.

FINDINGS OF FACT AND OPINION

Petitioner, who reported his income on the cash receipts and disbursements basis, was one of the organizers of a corporation in November, 1942. In November, 1942, he entered into an employment contract with the corporation under which he agreed to render services to it during the years 1943 and 1944. As part of his compensation, the corporation issued two certificates of stock in his name, each for 25 shares. He endorsed the certificates in blank and gave them to the treasurer of the corporation. Upon the satisfactory perform-

ance of the required services and pursuant to an order of the board of directors, the treasurer was to deliver one of the share certificates to petitioner at the end of each of the years 1943 and 1944. Held, the fair market value of 25 shares is includible in petitioner's income for each of the years 1943 and 1944, in which years they were delivered to him without restriction in consideration of services performed.

ELI FREED, ESQ.,
For the Petitioner.

T. M. MATHER, ESQ.,
For the Respondent.

The Commissioner determined deficiencies in the petitioner's income and victory tax liability for the year 1943 in the amount of $614.96, and a deficiency in petitioner's income tax liability for the year 1944 in the amount of $952.67. The year 1942 is also involved because of the provisions of the Current Tax Payment Act.

The issue in this proceeding is whether the fair market value of 50 shares of stock issued in petitioner's name in 1942 is includible in his gross income for that year, or whether the fair market value of 25 shares is includible in his gross income for each of the years 1943 and 1944 in which they were delivered to him without restriction.

The petitioner filed his returns for the years in question with the collector for the eighteenth district of Ohio. He is now a resident of Oakland, California.

The record in this proceeding consists of the testimony of the petitioner and a copy of the employment contract between the petitioner and the Ohio Aircraft Fixture Company which was introduced into evidence at the trial.

Findings of Fact

Petitioner was a resident of Cleveland, Ohio, from 1936 to 1945. During the years in question, he reported his income on the cash receipts and disbursement basis. From 1936 to November, 1942, he was employed by the American Coach and Body Company in Cleveland. Prior to leaving the company in November, 1942, he was the manager of its jig and fixture division.

In November, 1942, the Ohio Aircraft Fixture Company (hereinafter referred to as "Company") was incorporated under the laws of Ohio for the purpose of acquiring and operating the jig and fixture division of the American Coach and Body Company. The Company was organized by petitioner and three associates, Warnsman, Fortney, and Wilson. Petitioner purchased one share of stock from the Company at this time, and each of the other three organizers purchased ten shares of stock. The price paid for the stock was $100 per share. The $3,100 thus raised was adequate working capital for the needs of the Company which was organized to take over and operate a business which had valuable war production contracts and other assets sufficient for its operations.

The purchase of the jig and fixture division was

consummated in November, 1942, and the Company thereby acquired, on very lenient terms, a going concern, including its personnel, equipment, and valuable war production contracts.

On November 25, 1942, petitioner entered into an employment contract with the Company. This contract provided:

Employment Contract

* * *

The Parties hereto mutually agree as follows:

1. That the First Party [the Company] hereby hires the Second Party [petitioner] and the Second Party agrees to work for First Party in the capacity of Manager of the Service Engineering Department, in charge and responsible for all sales and advertising, formulating and figuring all selling prices in co-operation with the shop engineering and cost departments and to assist the factory manager in scheduling and planning production in First Party's business of general manufacturing, particularly aircraft, jigs and fixtures for a period of two (2) years, commencing on the 15th day of November, 1942, and ending on the 14th day of November, 1944.

2. Said Second Party shall at all times during such term of employment give his full attendance and to his best endeavors and to the utmost of his skill and abilities exert himself for the profit, benefit and advantage of said business and perform such

duties in said capacities as shall be required of him from time to time by First Party.

3. First Party shall pay the Second Party for his services hereunder as salary and compensation at the rate of One Hundred and Twenty-five ($125.00) per week in addition to ten per cent (10%) of the profits over $5,000.00 before Federal Taxes and after providing for all known reserves for contingencies; of the salary $100.00 is to be paid in cash each week, $25.00 and the said ten per cent, at the option of the Directors of the Company, may be paid in cash or in stock of the Company and shall be payable on or before January 15th of each year and shall cover the preceding year.

4. It is agreed by and between the parties that in case of illness, the base salary shall continue at full rate for six (6) months, half rate for a consecutive six (6) months and quarter rate for the balance of the term of the contract in excess of two six months periods, the additional salary, if any remaining the same. First Party through its Boards of Directors, if it deems advisable, may demand Certificate of Inability to perform on account of illness from one or more reputable physicians.

5. First Party shall issue fifty (50) shares of stock of the Company in consideration of the signing of this employment contract and to carry out certain contracts necessary in the prosecution of the war. Two certificates are to be issued. Each to be for twenty-five shares and endorsed in blank. They are to be deposited with the Treasurer of the

Company for the faithful performance of his contract. One certificate for twenty-five shares to be delivered on December 1, 1943, and the other certificate for twenty-five shares to be delivered on December 1, 1944, on the order of the Board of Directors.

6. Second Party agrees that during the life of this contract he will not engage in any manner either directly or indirectly engage [sic] in any other gainful occupation without consent of the Board of Directors; and shall further be directly responsible to the Board of Directors of the Company for the operation of his departments and said Directors shall from time to time determine the operating policies of these departments.

7. It is agreed by and between the parties that this contract will be considered performed on death of the Second Party.

Each of the other three organizers entered into similar employment contracts with the Company.

Pursuant to the employment contract, two stock certificates, each representing 25 shares of no-par value stock, were issued in petitioner's name in the latter part of 1942. He endorsed each stock certificate in blank and deposited it with the treasurer of the Company. Certificates representing fifty shares of stock similarly were issued in the names of each of the other three organizers who endorsed the certificates and deposited them with the treasurer of the Company.

Prior to the issuance of the stock, the board of

directors of the Company placed a value of $100 per share upon each of the shares of no-par value stock, which represented the fair market value of each share. The total number of shares of stock originally issued by the Company was 231. Of this number, 200 shares were issued to the organizers upon their execution of the employment contracts, and 31 were issued to the organizers upon the payment of $100 per share.

Petitioner began work for the Company on November 15, 1942. During 1943, petitioner received $6,500 as his base salary from the Company for his services as manager of its service engineering department, and additional compensation of $3,515 as his share of the profits above $5,000. In December, 1943, one of the stock certificates representing 25 shares of stock which had been issued in petitioner's name was delivered to him by the treasurer of the Company on the order of the board of directors.

During 1944, petitioner received $6,500 as his base salary from the Company and additional compensation of $3,290 as his share of the profits above $5,000. In December, 1944, the second stock certificate representing 25 shares of stock which had been issued in petitioner's name was delivered to him by the treasurer of the Company on the order of the board of directors.

In September, 1945, petitioner severed his connection with the Company and sold his shares of stock for $150 per share.

Petitioner became the unrestricted owner of 25 shares of stock in the Company in 1943 in exchange for services which he rendered to the Company in that year.

Petitioner became the unrestricted owner of 25 shares of stock in the Company in 1944 in exchange for services which he rendered to the Company in that year.

In the notice of deficiency, respondent gave the following explanation of the adjustments here in dispute:

Included in your salary for the year 1942 is the fair market value of $5,000.00 for 50 shares of Ohio Aircraft Fixture Company Stock.

Pursuant to an agreement made November 25, 1942, by and between Ohio Aircraft Fixture Company and you, fifty shares of the capital stock of that company were to be delivered to you in consideration of the signing of the employment contract and to carry out certain contracts necessary in the prosecution of the war. Two certificates were to be issued, each for twenty-five shares, endorsed in blank, and deposited with the treasurer of the company for faithful performance of the contract. One of the said certificates was delivered to you on December 1, 1943, and the second was delivered on December 1, 1944. It is held that the fair market value of each certificate constituted income to you in the year in which it was delivered on the order of the Board of Directors of the said Ohio Aircraft Fixture Company.

Opinion

Harron, Judge:

The issue in this proceeding is whether petitioner is taxable in 1942 on the value of shares of stock issued in his name in that year, or in 1943 and 1944 when the shares were delivered to him upon his performance of personal services pursuant to an executory contract with the Company.

Petitioner contends that he became the owner of the 50 shares in question in 1942 when the contract was signed by the parties and the shares were issued in his name; that the consideration for their issuance was the signing by him of the employment contract of November 25, 1942; and that the fair market value of the shares was income to him at that time.

Respondent contends that petitioner is taxable in 1943 and 1944 on the fair market value of the shares of stock received by him in those years and not in 1942 when the contract was entered into. He argues that the shares were only provisionally delivered to petitioner in 1942 and that petitioner did not become the unrestricted owner of any of the shares until 1943 and 1944, in each of which years 25 shares were delivered to him without restriction.

Petitioner reported his income during the years in question on the cash receipts and disbursement basis. Section 42 of the Internal Revenue Code provides that "the amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer." A taxpayer on the cash basis normally reports in-

come in the year in which the cash or property in lieu thereof is received, even though services for which the cash or property represent payment are rendered in either an earlier or a later year. Jackson v. Smietanka, 272 Fed. 970; S. P. Freeling, 7 B.T.A. 1238; Edwin B. DeGolia, 40 B.T.A. 845; cf. Brown v. Helvering, 291 U. S. 193; Astor Holding Corp. v. Commissioner, 135 Fed. (2d) 47; Your Health Club, Inc., 4 T.C. 385.

Although actual receipts remain the touchstone of the cash basis of reporting income, both decisions and regulations include constructive as well as actual receipts as income. E.g., Corliss v. Bowers, 281 U. S. 376; Ross v. Commissioner, 169 Fed. (2d) 483; Warren E. Burns, 11 B.T.A. 524; aff'd., 31 Fed. (2d) 399; certiorari denied, 280 U. S. 564. Regulation 111, section 29.42-3, which enunciates the doctrine of constructive receipt includes as taxable income all amounts owing to the taxpayer on the cash basis, whether actually received or not, which are unqualifiedly made subject to his demand in the taxable year.

Conversely, where cash or a chose in action, such as a stock certificate or a note, is not received free and clear but is subject to a restriction, the usual effect of the restraint is to postpone the inclusion of the item in taxable income until such time as the restriction is removed. E.g., International Mortgage & Investment Corp., 36 B.T.A. 187; Benjamin F. Patterson, 21 B.T.A. 8; Marion H. McArdle, 11 T.C. 961; Charles F. Mitchell, 45 B.T.A. 300; E. P. Madigan, 43 B.T.A. 549.

There is no evidence in this proceeding on such matters as who dictated the policies of the Company, what its capital structure was, what assets and liabilities comprised its balance sheet, whether any of the shares held by the treasurer were ever voted, whether dividends were ever declared by the Company, and, if so, whether dividends were ever paid by the Company upon the shares which were being held by the treasurer.

Upon our examination of the limited facts which have been made available to us, we must conclude that petitioner did not receive the 50 shares in question in 1942 free and clear from restrictions which would make them subject to his unfettered command. Instead, it is held that respondent was correct in his determination that it was not until 1943 and 1944 that the shares were subjected to petitioner's control, and that the fair market value of the shares delivered in each of those years was includible in petitioner's income for the year in which they were delivered.

The petitioner had no dominion or control over the shares until they were delivered to him by the treasurer of the Company in 1943 and 1944 upon the order of the board of directors. There is no evidence that the petitioner was entitled to vote the shares prior to that time or that he was entitled to share in any dividends which might be declared by the Company. The petitioner could not sell the shares which were being held by the treasurer until they were delivered to him, and the unfettered

right of sale is one of the most important attributes of ownership.

The facts which are before us in this proceeding are similar to those in other cases in which formal restrictive devices have resulted in tax postponement until the year in which the property was unrestrictedly delivered into the possession of the taxpayer. Thus, in Phillip W. Haberman, 31 B.T.A. 75; aff'd., 79 Fed. (2d) 995, the taxpayer agreed with a corporation to remain in the employ of one of its subsidiaries for three years for a compensation consisting of a stated cash salary and the right to purchase a stated number of shares of the parent's stock. Stock certificates for fully issued and paid-up shares were issued to the taxpayer, immediately endorsed by him, and deposited with the parent to secure a loan for the full purchase price of the shares. Upon repayment of the loan in installments, in subsequent years, the taxpayer was entitled to receive the shares of stock. Upon those facts, it was held that the taxpayer, who was on the cash basis, received income in the years in which the stock was finally received by him rather than in the year in which the stock was issued.

In Lyle H. Olson, 24 B.T.A. 702; aff'd. 67 Fed. (2d) 726; certiorari denied, 292 U. S. 637, a corporate employer agreed to issue 200 shares of its stock to Olson in consideration of his continuous performance of services for the next five years. Each year from 1918 through 1922 a certificate for 40 shares was issued in Olson's name and delivered to a trustee designated by him. In 1922 at the end

of the five years, the shares of stock were delivered to Olson. It was held that, since Olson reported his income on the cash basis, the entire 200 shares were includible in his income in 1922 in the amount of their fair market value. Cf. Adolph Zukor, 33 B.T.A. 324.

In Marion H. McArdle, supra, the taxpayer sold stock and as part of his consideration received a cashier's check which he endorsed and deposited with the buyer in order to guarantee the buyer against loss from accounts receivable and contingent liabilities of the corporation whose stock was being purchased. It was held that the profit represented by the portion of the sales price so deposited was not income to the cash basis seller in the year of sale, but only in the following year when received unconditionally. See, also, Preston R. Bassett, 33 B.T.A. 182; aff'd., 90 Fed. (2d) 1004.

And in Roscoe H. Aldrich, 3 B.T.A. 911, where a corporation agreed to compensate a taxpayer for entering into a contract with another corporation and becoming its general manager for a period of five years by depositing in escrow 500 shares of stock to be delivered to the taxpayer at the expiration of five years, the dividends payable on the stock during the escrow period to be paid to the taxpayer, it was held that the taxpayer did not become the owner of the stock until the expiration of the five years and its fair market value was includible in his income at that time. See, also, Charles F. Pearce, Jr., 6 B.T.A. 450; James R. Lister, 3 B.T.A. 475.

It seems clear that in exchange for his services for the next two years, the Company agreed to deliver to petitioner 25 shares of stock at the end of each year when the services had been performed. Performance of the services was a condition precedent to the delivery of the stock to petitioner. Petitioner argues that the signing of the contract to perform services in the future was sufficient consideration to make him the owner of the stock in 1942. But the Company was contracting for petitioner's services, not for his promise. The bare promise without the services had no value. The services called for by the contract were not performed until 1943 and 1944, in each of which years a certificate for 25 shares was delivered to petitioner for the services which he had rendered.

Moreover, a petitioner's contention that the mere signing of the contract was sufficient consideration for the transfer to him of ownership of the 50 shares is clearly contrary to the laws of the State of Ohio which were in effect at the time the parties entered into the contract. Section 8623-22, Page's Ohio Gen. Code Ann., in effect in 1943, reads as follows:

> Payment for shares.—* * * Shares shall be issued only for money, or for other property, real or personal, tangible or intangible, actually conveyed or transferred to the corporation for its use and lawful purposes, or in its possession as surplus, or for labor or services actually rendered to the corporation. [Emphasis added.]

* * *

> Every person who shall subscribe for shares without par value, or to whom such shares are to be issued, except as a share dividend, shall be obligated to pay the corporation therefor, in money or such other property or labor or services, such amount of consideration for each share as may have been determined as hereinbefore in this act provided.

Thus, under the laws of Ohio, petitioner could become the owner of the shares only upon the actual performance of the required services. See, also, Fletcher, Cyclopedia of the Law of Private Corporations (Perm. ed.), section 5187, pp. 424, et seq. And the laws in effect at the time shares of a corporation are issued become a part of the contract between the corporation and its shareholders and the parties to such agreement are presumed to know the extent of the authority granted the corporation by the applicable statutes then in effect. Schaffner v. Standard Boiler & Plate Iron Co., 150 Ohio St. 454, 83 N.E. (2d) 192.

Petitioner places considerable reliance upon the case of Schneider v. Duffy, 43 Fed. (2d) 642. However, the facts in Schneider v. Duffy are distinguishable from the facts in this proceeding. In the Schneider case, the employment agreement provided that the corporation would assign "an equitable ownership" in 1,500 shares of stock to Schneider; that he was "entitled to receive and enjoy all of said 1,500 shares"; and that all dividends declared on the 1,500 shares would be transmitted immedi-

ately to Schneider. Schneider also had the right to vote all 1,500 shares. As a basis for its decision that the fair market value of all 1,500 shares was income in the year in which the contract was executed, the district court of New Jersey emphasized the fact that the stock agreement was not a contract for additional salary, but that it was an incentive given to Schneider, who had no ownership in the company, to remain with the business after he had expressed an intention to sever his connection therewith and organize a competitive company.

In this proceeding, however, petitioner needed no incentive in the form of stock to work for the Company. His former job as manager of the jig and fixture division of the American Coach and Body Company no longer existed upon the sale of that division outright to the Company. The Company did not agree to deliver a total of 50 shares of its stock to petitioner in order to persuade him to leave his employment with another corporation or to influence him to remain with the Company after he had expressed his intention to leave. Petitioner already had sufficient incentive as one of the organizers of the Company. In addition, under the employment contract, petitioner was entitled to 10 per cent of the profits earned each year by the Company above $5,000.

The facts in this proceeding are more closely akin to those relied upon by the Board of Tax Appeals in Anthony Schneider, 3 B.T.A. 920, where it was held that income was taxable in the years subsequent to the issuance of stock, which considered

the same fact situation as that present in Schneider v. Duffy, supra, than they are to those relied upon by the court in the latter case. In the Board's view of the evidence, the agreement was entered into by the company in exchange for the services of Schneider and his agreement to remain with the company for the next five years. On these facts, the Board held that "performance of the agreements was the quid pro quo to the delivery of the absolute title to the stock," rather than the issuance of the stock, and that the fair market value of the stock was includible in Schneider's income in the years in which the certificates therefor were delivered to him without restriction. In subsequent cases, we have cited this decision of the Board with approval. Charles F. Pearce, supra; K. E. Merren, 18 B.T.A. 159; Lyle H. Olson, supra; Albert R. Erskine, 26 B.T.A. 155; Charles Chaplin, 46 B.T.A. 385; reversed on another issue, 136 Fed. (2d) 298.

Petitioner also relies upon Chaplin v. Commissioner, 136 Fed. (2d) 298; reversing in part 46 B.T.A. 385. We fail to see how that decision is authority for the contentions made by the petitioner. In the Chaplin case, the stock was issued in consideration of property in the form of photoplays to be delivered by Chaplin to the corporation, rather than for services to be rendered in the future. The stock was placed in escrow until such time as Chaplin delivered the photoplays. In reversing the decision of the Board of Tax Appeals that the fair market value of the stock was includible in Chaplin's income in the year in which he delivered the photoplays and the stock was re-

turned to him, the Court of Appeals relied upon the fact that the agreement specifically provided that Chaplin was the owner of the stock; that Chaplin had at all times the right to vote the stock; and that dividends on the stock were declared and paid to the escrow agent who held them for Chaplin's benefit. These facts are not present in the instant proceeding. Moreover, on the issue of whether the dividends which had been declared on the stock and paid to the escrow agent for Chaplin's benefit in prior years were includible in Chaplin's income in the year in which they were released to him upon delivery of the photoplays, the Court of Appeals held that the dividends were properly includible in Chaplin's income in the year of their release when they were unqualifiedly made subject to his demand, rather than in the years in which they were paid to the escrow agent. The decision on this issue supports the contention of respondent that the fair market value of the shares of stock was not includible in petitioner's income until the years 1943 and 1944, in each of which years 25 shares were delivered to petitioner without restriction.

It is held that the fair market value of the 25 shares delivered to petitioner in the year 1943 is includible in his gross income for that year, and the fair market value of the 25 shares delivered to petitioner in the year 1944 is includible in his gross income for that year.

Decision will be entered for the respondent.

Served August 31, 1950.

The Tax Court of the United States
Washington
Docket No. 21027

FRED C. HALL,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the determination of the Court in its Findings of Fact and Opinion promulgated on August 31, 1950, it is

Ordered and Decided: That there is a deficiency in income and victory tax for the year 1943 in the amount of $614.96, and that there is a deficiency in income tax for the year 1944 in the amount of $952.67.

[Seal] /s/ MARION J. HARRON,
Judge.

Entered Aug. 31, 1950.

Served Sept. 1, 1950.

In the United States Court of Appeals
for the Ninth Circuit
Tax Court Docket No. 21027

FRED C. HALL,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR REVIEW

Taxpayer, petitioner in this cause, by Eli Freed, Emmett Gebauer, and Scott Fleming, counsel, hereby files his petition for a review by the United States Court of Appeals for the Ninth Circuit of the decision by the Tax Court of the United States promulgated August 31, 1950, 15 T.C. No. 30, determining deficiencies in petitioner's federal income and victory taxes for the calendar year 1943 in the amount of Six Hundred Fourteen and 96/100 Dollars ($614.96), and in petitioner's federal income taxes for the calendar year 1944 in the amount of Nine Hundred Fifty-two and 67/100 Dollars ($952.67), the decision determining said deficiencies having been rendered and entered August 31, 1950, after hearing by the Tax Court of the United States held in San Francisco, California; and petitioner respectfully shows:

I.

The petitioner, Fred C. Hall, is an individual residing in San Carlos, California; petitioner filed

the income tax returns involved with the Collector of Internal Revenue for the Eighteenth District of Ohio.

It has, however, been stipulated in writing between the petitioner and the Commissioner of Internal Revenue, respondent herein, pursuant to the provisions of Internal Revenue Code Sec. 1141 (b) (2), that the aforesaid decision of the Tax Court of the United States may be reviewed by the United States Court of Appeals for the Ninth Circuit. Said stipulation is attached hereto and marked "Exhibit A."

II.

Nature of the Controversy

The controversy involves the proper determination of petitioner's liability for federal income taxes and victory taxes for the calendar years 1942 and 1943, and income taxes for the calendar year 1944.

In 1942 the petitioner was employed in Cleveland, Ohio, by the American Coach and Body Company, an Ohio corporation, as manager of its Jig and Fixture Division. In November of 1942 the Ohio Aircraft Fixture Company, an Ohio corporation, acquired said Jig and Fixture Division, and proceeded to operate this division as a separate corporate business. On November 25, 1942, petitioner accepted employment with said Ohio Aircraft Fixture Company under a contract providing in substance as follows:

1. That petitioner would work for the Ohio Aircraft Fixture Company for two years.

2. That he would be paid a stipulated, reasonable, fixed salary.

3. That he would receive a bonus of ten per cent (10%) of the profits over Five Thousand Dollars ($5,000.00) per year.

4. That part of said salary and all of said bonus might be paid in stock of the corporation.

5. That the corporation would issue fifty (50) shares of its stock to petitioner in the form of two twenty-five share certificates; that petitioner was to endorse said certificates in blank and deposit them with the treasurer of the company to secure the faithful performance of the contract; said certificates were to be redelivered to petitioner, one in 1943 and the other in 1944.

In accordance with this contract fifty shares of stock were issued to petitioner in 1942, endorsed and deposited by him, and returned to him, twenty-five shares in 1943 and twenty-five shares in 1944.

Petitioner reported the fair market value of these shares of One Hundred Dollars ($100.00) per share, or Five Thousand Dollars ($5,000.00), as ordinary income on his return for the calendar year 1942.

The Commissioner of Internal Revenue asserted tax deficiencies for the calendar years 1943 and 1944 on the ground that the income represented by said shares of stock was not realized by petitioner in 1942 but was instead realized one-half in 1943 and the other half in 1944.

III.

The aforesaid assertion of tax deficiencies was sustained by the Tax Court of the United States, and petitioner, being aggrieved by the findings of fact and opinion of said Court and by its decision entered pursuant thereto, desires to obtain a review thereof by the United States Court of Appeals for the Ninth Circuit.

IV.

Points on Which Petitioner Relies

The petitioner relies upon the following points:

1. The contract and the testimony require the conclusion that petitioner became the beneficial, equitable, and substantial owner of the shares of stock in question in 1942, and that the value thereof constituted taxable income to the petitioner in 1942.

2. The contract under which the shares were issued to petitioner and deposited by him with the company requires the conclusion that both parties to said contract intended that petitioner became a shareholder in 1942, when the fifty shares in dispute were originally issued to him, and that the deposit of said shares with the corporation was merely a pledge or security device which did not prevent realization of income in 1942.

3. Creditable, uncontradicted, and unimpeached testimony of the petitioner, the only witness at the hearing, requires the conclusion that petitioner became a shareholder in 1942, and that the deposit of his shares with the company was merely a pledge

or security device which did not prevent realization of income in 1942.

4. A taxpayer on the cash receipts basis is required to include income in his return for the taxable year during which the income is received. Income in the form of property, including shares of corporate stock, is received or realized in the year in which the taxpayer becomes the beneficial, equitable, or substantial owner of such property or shares.

5. Even though tangible share certificates are not then actually issued, income arising by virtue of the creation of the legal relationship of shareholder in a corporation is realized in the year such relationship is created.

6. The fact that a taxpayer receives the beneficial, equitable, or substantial ownership of corporate shares or other property constituting income to him, subject to restrictions in that such corporate shares or property must be pledged or deposited as security or that the taxpayer's use thereof is otherwise restricted, does not prevent or postpone realization of the income represented thereby.

7. A cash basis taxpayer is required to include an item in gross income for the year in which it is received, even though the services for which it constitutes compensation are not to be rendered until a subsequent year.

8. The Tax Court erred in relying as a partial

or supporting reason for sustaining the Commissioner's contentions on the ground that under Ohio law the shares could not have been issued to petitioner in 1942, which issue or contention had not been raised by respondent's answer to the petition nor referred to in any way in the trial or argument of the case or the briefs submitted therein, and regarding which issue petitioner had no reason to expect that he should put in any evidence and no opportunity to present evidence, and which is contrary to the Commissioner's stipulation in open court that the shares in question were issued in 1942, and contrary to the undisputed fact that the shares in question had, in 1942, a fair market value of One Hundred Dollars ($100.00) per share, or Five Thousand Dollars ($5,000.00).

9. The Tax Court erred in concluding that under the facts and circumstances of this case the Ohio law operated to prevent petitioner from having the status of a shareholder in 1942 in accordance with the contract and intention of the parties.

10. The Tax Court erred in relying on facts and assumptions not in evidence and not supported by the evidence.

11. The Tax Court erred in making the following findings of fact:

> "Petitioner became the unrestricted owner of 25 shares of stock in the Company in 1943 in exchange for services which he rendered to the Company in that year.

"Petitioner became the unrestricted owner of 25 shares of stock in the Company in 1944 in exchange for services which he rendered to the Company in that year."

12. The decision of the Tax Court is not supported by the evidence and is contrary to the evidence.

13. The decision of the Tax Court rests on errors of law and is contrary to law.

14. The Tax Court erred in determining the deficiencies for the years 1943 and 1944 and that the income in question was not properly reported and the tax paid thereon for the year 1942.

/s/ ELI FREED,

/s/ EMMETT GEBAUER,

/s/ SCOTT FLEMING,
Counsel for Petitioner.

Received and filed T.C.U.S. November 24, 1950.

[Title of Court of Appeals and Cause.]

NOTICE OF FILING PETITION FOR REVIEW

To the Commissioner of Internal Revenue, respondent herein, and to Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, Washington, D. C., his attorney:

You are hereby notified that the petitioner has filed on or about November 24, 1950, with the Clerk

of the Tax Court of the United States at Washington, D. C., a petition for review by the United States Court of Appeals for the Ninth Circuit of the decision of the Tax Court of the United States heretofore rendered in the above-entitled matter. A copy of the petition for review and the designation of contents of record on review, as filed herein, are attached to this notice and served herewith.

Dated: November 22, 1950.

/s/ ELI FREED,

/s/ EMMETT GEBAUER,

/s/ SCOTT FLEMING,
Counsel for Petitioner.

Acknowledgment of Service attached.

Received T.C.U.S. November 24, 1950.

Filed T.C.U.S. November 27, 1950.

[Title of Tax Court and Cause.]

CERTIFICATE

I, Victor S. Mersch, Clerk of The Tax Court of the United States hereby certify that the foregoing documents, 1 to 12, incusive, constitute and are all of the original papers and proceedings on file in my office as called for by the Designation as to Contents of Record on Review in the proceeding before The Tax Court of the United States entitled, "Fred C. Hall, Petitioner, v. Commissioner of Internal Reve-

nue, Respondent," Docket No. 21027 and in which the petitioner in The Tax Court proceeding has initiated an appeal as above numbered and entitled, together with a true copy of the docket entries in said Tax Court proceeding, as the same appear in the official docket book in my office.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 13th day of December, 1950.

[Seal] /s/ VICTOR S. MERSCH,
Clerk.

[Endorsed]: No. 12803. United States Court of Appeals for the Ninth Circuit. Fred C. Hall, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Petition to Review a Decision of The Tax Court of the United States.

Filed December 30, 1950.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

[Title of Court of Appeals and Cause.]

POINTS ON WHICH PETITIONER INTENDS TO RELY

As and for the points on which petitioner intends to rely, petitioner hereby refers to and incorporates herein, as though fully set forth, the points on which petitioner relies constituting paragraph IV, subparagraphs 1 through 14, inclusive, commencing on page 4 and ending on page 7 of petitioner's Petition for Review heretofore filed herein and constituting Document No. 5 in the attached Designation of Printed Record for Review of Tax Court Decision.

Dated: January 15, 1951.

/s/ ELI FREED,

/s/ EMMETT GEBAUER,

/s/ SCOTT FLEMING,
Counsel for Petitioner.

Affidavit of Service by Mail attached.

[Endorsed]: Filed U.S.C.A. January 23, 1951.

No. 12,803

IN THE

United States Court of Appeals

For the Ninth Circuit

FRED C. HALL,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition to Review a Decision of the Tax Court of the United States.

PETITIONER'S OPENING BRIEF.

FREED, GEBAUER & FREED,
1069 Mills Building, San Francisco 4, California,
Counsel for Petitioner.

ELI FREED,
EMMETT GEBAUER,
SCOTT FLEMING,
1069 Mills Building, San Francisco 4, California,
Of Counsel.

FILED
APR 11 1951
PAUL P. O'BRIEN,
CLERK

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No. 12,803

IN THE

United States Court of Appeals

For the Ninth Circuit

FRED C. HALL,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition to Review a Decision of the Tax Court of the United States.

PETITIONER'S OPENING BRIEF.

STATEMENT OF THE CASE.

Petitioner, who before November of 1942 was the manager of the Jig and Fixture Division of The American Coach and Body Company, in Cleveland, Ohio, was one of four organizers of the Ohio Aircraft Fixture Company, a corporation organized in November of 1942 to purchase said Jig and Fixture Division from The American Coach and Body Company. (Tr. p. 35.)

The Division was taken over intact with its personnel and valuable war production contracts, on very lenient terms, so that no cash was required for the purchase, and the new concern (the Ohio Aircraft

Fixture Company, hereafter called the corporation) needed only a small amount of capital in cash as current working capital. (Tr. pp. 22, 35, 36.)

The corporation issued shares as follows:

(1) Fifty shares were issued to each of the four organizers upon the signing of certain contracts between the organizers and the corporation. The contracts, which were similar, at least insofar as material to the issues in this proceeding, provided that each of the organizers was to work for the corporation for two years for a certain salary, and an additional salary or bonus. (Tr. pp. 38, 39.)

The contracts contained miscellaneous provisions regarding the effect of death or illness on compensation, and commitments to use best efforts on behalf of the corporation, and not to engage in other gainful employment.

Each contract provided for the issuance of said fifty shares of stock to the organizer.

The petitioner's contract appears at pages 14-17 of the transcript.

In accordance with the provisions of paragraph 5 of his contract, said fifty shares of stock were issued to petitioner in 1942 as follows:

Two certificates, in petitioner's name, each for twenty-five shares, were delivered to petitioner, endorsed by him in blank, and "deposited with the Treasurer of the Company for the faithful performance of this contract." (Tr. pp. 13, 14, 19, 20, 25, 38, 39; Contract ¶5.)

Petitioner completely performed the contract, and the certificates were released to him, one in 1943, and the other in 1944, after one and two years respectively. (Tr. pp. 20, 39.)

When issued in 1942 the shares had a fair market value of $100.00 per share. (Tr. p. 39.)

Petitioner sold his shares to others of the original organizers in 1946 for $150.00 per share. (Tr. pp. 24, 39.)

The corporation has since been dissolved. (Tr. p. 24.)

Petitioner reported the shares as ordinary income in 1942 at their fair market value of $100.00 per share. (Tr. pp. 29, 30, 40.)

The Commissioner determined that the income represented by the shares was not realized in 1942, but was realized one-half in 1943 and one-half in 1944, when the certificates which had been deposited with the corporation pursuant to the contract were released to petitioner. (Tr. pp. 12, 13, 40.)

Abstract of questions presented.

Fundamentally the question presented is whether income in the form of shares in a corporation was taxable income to the petitioner in 1942 when he reported it, or one-half in 1943 and one-half in 1944, according to the Commissioner's determination, which the Tax Court has sustained.

For purposes of analysis, this question may be broken down as follows:

(1) On the basis of the facts established by the record and the application of correct legal principles thereto, what was petitioner's relation to the stock in 1942, and, more particularly, did petitioner own the stock in 1942, subject to a pledge as security for the performance of an employment contract, as he contends, or was his interest in the stock in 1942 so limited as to amount in substance merely to a right to receive stock in the future, as contended by the Commissioner?

(2) On the basis of the answer to question 1, when was the income represented by the stock realized by petitioner, a cash basis taxpayer,—in 1942, as he contends and as he reported it, or in 1943 and 1944, as determined by the Commissioner?

SPECIFICATION OF ERRORS.

Petitioner's full specification of errors appears in the transcript at pages 55-58, paragraph IV, under the heading "Points on Which Petitioner Relies", to which reference is hereby made.

Petitioner's points may be summarized as follows:

(I) The contract in question, the circumstances surrounding the issuance of the shares, and petitioner's uncontradicted and unimpeached testimony, considered in the light of established principles of corporation and security law required the Tax Court to find, and said court erred in not finding,

a. that the shares in question were issued to petitioner in 1942, and that he then became the owner thereof.

b. that petitioner's ownership of the shares in 1942 was restricted only by a pledge thereof to the corporation, as security for his performance of the contract.

(II) Established principles of corporation, security, and taxation law required the Tax Court to hold, and said court erred in not holding, that the income represented by the stock was realized and properly reported in 1942, and that there exists no tax deficiency for 1943 or 1944.

ARGUMENT.

I.

THE SHARES WERE ISSUED TO AND OWNED BY PETITIONER IN 1942, SUBJECT ONLY TO A PLEDGE TO THE CORPORATION AS SECURITY.

Because this case is essentially simple, and upon realistic analysis petitioner's position seems so clearly correct, it is counsel's desire to present the most concise argument consistent with a fair presentation of the case.

However when one moves from the contract and the transcript of the hearing to the opinion of the court, one passes from the real world down a rabbit hole to Wonderland; definite facts become clouded and elusive, and things are not what they seem. And concise discussion becomes difficult.

The controversy turns mainly on the effect of paragraph 5 of petitioner's employment contract, and acts done in performance thereof, interpreted, of course, in the light of surrounding circumstances and pertinent testimony. Said paragraph 5 provides (Tr. p. 16):

> "First Party shall issue fifty (50) shares of stock of the Company in consideration of the signing of this employment contract and to carry out certain contracts necessary in the prosecution of the war. Two certificates are to be issued. Each to be for twenty-five shares and endorsed in blank. They are to be deposited with the Treasurer of the Company for the faithful performance of this contract. One certificate for twenty-five shares to be delivered on December 1, 1943 and the other certificate for twenty-five shares to be delivered on December 1, 1944, on the order of the Board of Directors."

The court found that, pursuant to such provision, certificates for fifty shares of stock were issued in petitioner's name and in the names of each of the other three organizers, endorsed by the person named therein, and deposited with the corporation treasurer. (Tr. pp. 38, 39.)

This finding doesn't say whether petitioner's shares were issued *to him* and *pledged* by him. ("[*I*]*ssued in petitioner's name*"[1] and "He endorsed each stock certificate and deposited it with the treasurer * * *") (Tr. p. 38.) But if the shares were issued they must have been issued to petitioner and the other organ-

[1]Unless otherwise indicated, emphasis is added by counsel.

izers; a corporation can't issue shares to itself any more than a person can contract with himself.

We are further enlightened by the following:

> "The total number of shares of stock originally issued by the company was 231. Of this number, 200 shares were *issued to the organizers* upon their execution of employment contracts, and 31 were issued to the organizers upon the payment of $100.00 per share." (Tr. p. 39.)

Thus it appears from the findings of fact that the shares in question were originally—at the outset in 1942—*issued to the petitioner* upon his execution of the contract.

But we still don't know from the court's opinion what next occurred when the petitioner endorsed the shares and caused them to be "deposited with the Treasurer * * * for the faithful performance of his contract." (Contract ¶5; Tr. pp. 37, 38.) Did he pledge the certificates—was this a security transaction? Or did he "unissue" the shares?

All we find out is that "Petitioner became the unrestricted owner of 25 shares of stock in the Company in 1943 in exchange for services which he rendered to the Company in that year." (And similarly as to the other 25 shares in 1944.) (Tr. p. 40.)

We don't know what "becoming the unrestricted owner" involved—a release of the shares from a pledge made as security; perhaps, contrary to the finding that the shares were issued in 1942, an original issuance of the stock; or perhaps the removal of the corporate shares from some novel legal deep freeze

which operates to prevent issued and outstanding shares from being owned by the person to whom issued, by the corporation, or by anyone else—contracts between the corporation and the little man who wasn't there!

The resolution of this legal and factual paradox is not difficult; either (1) the shares were issued to and owned by the petitioner in 1942, and the certificates representing his shares were pledged by him to the corporation as security for the performance of his contract, or (2) the shares were not issued at all, and the petitioner merely had a right to have shares issued to him in the future, on certain conditions.

Fact and law unite to demonstrate that the first of the above alternatives is the correct and only tenable conclusion.

A.

FUNDAMENTALS OF CORPORATION AND SECURITY LAW ESTABLISH THAT THE SHARES WERE ISSUED TO AND OWNED BY PETITIONER IN 1942, AND PLEDGED BY HIM TO THE CORPORATION.

Before further analysis of the facts, it may be helpful to touch briefly on the law which imparts to those facts their true legal significance.

1. Petitioner became the owner of the shares immediately upon the execution of the contract.

Paragraph 5 calls for the *issue* of 50 shares of stock. It is fundamental corporation law that the issue of stock means the formation of a share contract between shareholder and corporation. Such a contract must have two parties. A corporation cannot issue

shares to itself. The issue of stock by a corporation makes the other party to the issue contract a shareholder and an owner of shares. The share certificates are mere evidence of the shareholder relation and are not essential to its creation.

Professor Henry Winthrop Ballantine states:

> "Shares of stock are contracts issued or created by mutual assent of the corporation and the shareholder * * * The word 'issue' is generally employed to indicate the making of a share contract, that is, transactions by which a person becomes the owner of shares and by which new share contracts are created. The word 'issue' is often associated with the execution and delivery of a share certificate but the issue of shares is not dependent on the delivery of a certificate for the shares. A person may become the owner of shares in a corporation either by subscription or the original issue of shares by agreement with the corporation * * *"
>
> *Ballantine on Corporations* (Rev. Ed. 1946), Section 199, pp. 466, 7.

To the same effect:

> 11 *Fletcher, Cyclopedia Corporations* (Perm. Ed.), Sections 5155, 5159.

As a matter of realistic interpretation of the contract in the light of fundamental corporation law it is submitted that petitioner intended to become and became a shareholder upon the signing of the contract, or at the latest, when the certificates made out in his name were delivered to him for endorsement. Although the term "shall issue" could indicate a future

issue, the only provision as to time of issue is "in consideration of the signing of this employment contract * * *"; the contract clearly indicates that an immediate issue of shares to petitioner was intended.

The provisions respecting certificates, though apparently regarded as defining the manner in which the shares were to be issued, are, as a matter of corporation law, not essential to the issuance of stock. However, the contract goes on to provide for the issue of certificates and their endorsement in blank by petitioner. It was stipulated (Tr. pp. 13, 14) and proved by testimony (Tr. pp. 19, 20, 25) that these things were done (i.e., that shares were issued to Mr. Hall and that the certificates representing them were delivered to and endorsed by him) in 1942. That is to say, respondent stipulated that petitioner became a shareholder of the 50 shares in question in 1942.

It is difficult for petitioner's counsel to see what remains to be argued after that stipulation. Assume for a moment that the positions of the parties were reversed, and that petitioner, instead of defending his inclusion of the shares in his 1942 return, was attempting to justify his failure so to report the transaction. The court may judge the success which petitioner would have in maintaining the position that the shares did not constitute income in 1942, in the face of a stipulation and uncontradicted and unimpeached testimony that they had been issued to and endorsed by him in that year.

2. The contract shows that a pledge was intended; a pledgor is the substantial owner of pledged property.

The phrase "deposited * * * for the faithful performance of this contract" makes it unmistakably clear that paragraph 5 contemplates a security transaction and is not a provision deferring the issuance of shares to petitioner, or petitioner's ownership of the stock in question, until the redelivery of the certificates. In a word the paragraph provides for a pledge. It is equally clear that a pledgor of stock is the owner thereof, subject only to whatever rights are given to the pledgee by the pledge contract, as interpreted in the light of the law respecting pledges.

A physical transfer of share certificates intended as security will be treated as a pledge, and contractual provisions to defeat the pledgor's ownership, e.g., provisions purporting to give absolute ownership or control to the pledgee, will be held invalid, under the public policy that provisions clogging the right of redemption are void.

Therefore the last sentence of the share issue and pledge provisions (Contract, ¶5) providing for the certificates being released to petitioner on designated future dates "on the order of the Board of Directors" can only be regarded as mechanical provisions governing termination of the pledge, and not as a clog on or condition precedent to petitioner's ownership of the shares. (Of course a pledgee must in the first instance determine whether the secured obligation has been performed, but his determination thereof cannot deprive the pledgor of his property, except through legal foreclosure proceedings.)

In *Hawley v. Hawley* (C.A.D.C. 1940), 114 F. (2d) 745, shares had been transferred under an agreement showing that a security transaction was intended. A clause providing clearly that the stock would become the transferee's property on failure to pay the obligations secured was held to be of no effect. The court quoted from *Haselden v. Hamer* (1914), 97 S.C. 178, 184, 81 S.E. 424, 425: "The pledgee is not entitled upon the pledgor's default to take the property as his own in satisfaction of the debt. A provision in the contract by which the absolute property is to vest in the pledgee upon the default of the pledgor is void * * *" It went on to declare correctly that this is a universally accepted rule, citing annotation 24 A.L.R. 822.

Regardless of what designations may be technically most appropriate for describing the respective rights of pledgor and pledgee, it is clear that the pledgor retains the general property in and ownership of the property pledged, and the pledgee receives but a special property right only extensive enough to provide security for the obligation secured. For example a pledgor may transfer the pledged property, subject, however, to the pledge.

Brightwell v. First National Bank of Kissimmee (C.C.A. 5th, 1940), 109 F. (2d) 271.

In *Lawrence v. I. N. Parlier Estate Co.* (1940), 15 Cal. (2d) 220, the court discusses generally the consequences of pledging stock in a corporation to that corporation.

As far as time of realization of income is concerned it is difficult to see how the transaction would have

been different had the contract provided for issuance to petitioner of Ohio Aircraft Fixture Company stock, and for petitioner to deposit as security for performance, General Motors stock, or even a diamond ring. The tax consequences of the issuance of stock should not be altered because that stock, instead of something else of similar value, has been made security for performance of the contract under which the stock was issued.

It is hoped that the foregoing brief review of applicable legal principles is sufficient to show that *if* the parties intended an immediate share issue and *if* they intended a deposit as security, the result would be that in 1942 petitioner was a shareholder and the owner of the shares in question, his ownership being restricted only by the valid terms and legal incidents of the pledge provisions.

What, then, are the facts?

B.

THE CONTRACT, THE CIRCUMSTANCES SURROUNDING THE TRANSACTION, AND PETITIONER'S DIRECT, UNCONTRADICTED, AND UNIMPEACHED TESTIMONY COMBINE TO DEMONSTRATE THAT AN IMMEDIATE ISSUE AND PLEDGE AS SECURITY WAS INTENDED AND EFFECTED.

1. The contract on its face compels one to conclude that petitioner became a shareholder in the Ohio Aircraft Fixture Company in 1942.

In addition to ¶5 quoted and discussed above, the contract, set forth in full at Transcript pp. 14-17, provided in substance as follows:

¶1. Petitioner was to manage a department of the Ohio Aircraft Fixture Company for two years.

¶2. He was to exert his best efforts, skills, and abilities for the profit of the company.

¶3. As compensation for his services he was to receive a salary of $125.00 per week, plus ten per cent of corporate profits, part of the weekly salary and all of the percentage of profits being payable in stock at the option of the company.

¶4. In the event of disabling illness, the weekly salary was to continue in full for six months, at one-half for the following six months, and at one-quarter for the remaining duration of the contract; petitioner's additional salary (the percentage of profits) was to continue unaffected, even though illness prevented him from rendering the services provided in the contract.

¶5. Quoted at page 6, supra.

¶6. Petitioner covenanted not to engage, for the duration of the contract, in any other gainful occupation without consent of the Board of Directors.

¶7. The contract was to be considered performed on death of the petitioner.

Clearly the contract contemplated the immediate present issuance of stock to petitioner—the present creation of the status of shareholder—and the pledge of such stock as security for the performance of the contract.

This construction is indicated by the stated consideration for the share issue. (¶5, p. 6, supra.) "* * * the signing of this employment contract and to carry out certain contracts necessary in the prosecu-

tion of the war." This language shows the consideration for the issuance of shares—"the signing of this employment contract"—and the corporate purpose to be achieved thereby—the securing of petitioner's undertaking to perform duties necessary to carry out the war contracts referred to. If there is any ambiguity on this score, it is resolved by testimony of the petitioner. (Tr. pp. 25, 26.)

Obviously, he was not receiving the shares in return for services to be rendered because the shares were to belong to him even though his death (¶7) or his illness (¶4) prevented him from rendering services. Furthermore, he was to be paid a regular salary for rendering services, and an additional salary or bonus of a percentage of profits, also as compensation for services. (¶3.) This in itself was an incentive compensation arrangement; and because part of the regular and all of the additional salary were payable in stock, at the company's option, it also served as a stock-bonus type of incentive plan.

Why, then, did the contract provide that stock was to be issued to petitioner at the outset? The only fair answer, based on the contract itself, is, *to make him a shareholder at that time.*

Perhaps he would not have come into the enterprise at all unless he was to be a substantial shareholder from the start. Regardless of the terms of bargaining, which are not known, the bargain made, calls, in terms, for him to be made a shareholder immediately.

2. **The circumstances surrounding the transaction compel one to conclude that petitioner became a shareholder in the Ohio Aircraft Fixture Company in 1942.**

Petitioner was one of four promoters or organizers of the company in question, the Ohio Aircraft Fixture Company. (Tr. pp. 18, 35.) Because he was and had for some time been the manager of the Jig and Fixture Division of The American Coach and Body Company, which division was to become the entire business of the Ohio Aircraft Fixture Company (Tr. pp. 18, 35), the assured continuation of his services was obviously of great importance to the new concern. The organization took place early in the war, when the services of personnel skilled and experienced in management of war production operations were of great value. The record does not show, nor does it appear important, exactly what the relative contributions of petitioner and the other organizers were. It does appear that each organizer received fifty shares of stock on executing an employment contract, and that the other three each bought ten shares for cash at $100.00 per share, whereas petitioner purchased only one share for cash. (Tr. pp. 21, 35.)

It further appears that the new company had little need for capital because it took over a going concern (the Jig and Fixture Division which petitioner had been managing) on very lenient terms, and also took over valuable war production contracts. (Tr. pp. 22, 35, 36.)

Clearly, petitioner was a key man, of sufficient importance to enter the new concern as nearly a one-

fourth owner, without the investment of any substantial amount of cash.

Petitioner submits that under these circumstances, the contract between him and the corporation and similar contracts of the other promoters clearly establish the intention of all the organizers and of the corporation, which was their creature, that they should all, from the outset, be the shareholders of the corporation.

It does not make sense that the promoters and organizers of such an enterprise should not be substantial shareholders from the outset. It does not make sense that petitioner would not insist, in exchange for his contribution to the establishment of the new enterprise, on being a shareholder from the outset. If the shares were issued for services, the services were his past efforts as a promoter, not future work as an employee.

3. Petitioner's uncontradicted and unimpeached testimony, fully corroborated by the contract and the surrounding circumstances, shows that he became a shareholder in 1942.

Petitioner testified that the shares were issued in his name; that the certificates made out in his name (Tr. p. 19) were actually delivered to him (Tr. p. 19), endorsed by him (Tr. p. 20), and deposited as security, in accordance with the contract.

In response to questions of the court he testified that the shares were issued to him in 1942 (Tr. p. 25) and that they were issued as an incentive to him to leave his old job and undertake the responsibility of

completing contracts being taken over with the business. (Tr. p. 23.)

To questions of the court regarding the contract, especially paragraph 5, he testified that prior to the signing of the contract it was agreed that *he was to receive fifty shares of stock for signing the contract,* and was to endorse the certificates back to a prescribed officer of the company. (Tr. p. 25.)

The court asked petitioner his understanding of the provision requiring him to endorse the certificates and return them to the treasurer of the company. (Tr. p. 26.)

Petitioner referred to the responsibility the company had for carrying out certain war contracts, and stated his understanding to be that if he failed to perform his contract he would need to be replaced, and that expenses or damages resulting from his failure to perform or his replacement could be recovered from the stock which had been issued to him and deposited with the company. (Tr. p. 26.)

This is exactly what the contract, in terms and in legal effect, provides. It is consistent with and realistic in view of the circumstance that he was one of the four organizers of the company—one of four men who were able to take over a going war-production business in 1942, not by investment (for the $3,100 cash investment was to provide working capital (Tr. pp. 21, 22), not a down or partial payment on the purchase of assets, for which purpose it is clearly ridiculously small), but simply by agreeing to manage it, and see that the lenient terms of purchase were met.

The corporation was clearly a device by which the four organizers acquired ownership in 1942 of the Jig and Fixture Division of The American Coach and Body Company.

A conclusion that petitioner was not the owner of the stock in 1942 can only be reached by ignoring his testimony—testimony entirely consistent with and corroborated by the contract and the surrounding circumstances, and free from impeachment and contradiction.[2]

Perhaps more important, petitioner's affirmative and unequivocal act in reporting the value of the stock as ordinary income for 1942 shows that, as he then understood the transactions involved, he had received the shares in 1942, and then owned them.

The united, consistent, mutually supporting forces of the contract, the factual context of the transactions involved, petitioner's testimony, and petitioner's conduct, show to the point of demonstration that petitioner became the owner of the shares in 1942 and that he then pledged the certificates as security for the performance of his contract.

It has seemed necessary to belabor the point because of the decision of the Tax Court herein; however, there appears in fact to be no real question,

[2]It seems clearly established that uncontradicted unimpeached testimony which is not inherently improbable nor inconsistent with established facts and circumstances must be accepted by the Tax Court and cannot be arbitrarily disregarded. *Grace Bros. v. Commissioner* (C. A. 9th, 1949), 173 F.(2d) 170, at 174; see also, *J. H. Robinson Truck Lines v. Commissioner* (C. A. 5th, 1950), 183 F. (2d) 739, at 740, and cases there cited.

because it was stipulated (Tr. pp. 13, 14) and seemingly found (Tr. pp. 38, 39) that the shares were issued to petitioner in 1942.

Effect of Ohio statutory provisions respecting consideration for shares.

Although respondent's answer contains nothing suggesting that invalidity of the shares under provisions of local law was to be relied on; although respondent stipulated that the shares were issued, which must mean validly issued, in 1942; although the question of validity under Ohio law was in no way raised or suggested at the hearing; although the effect of Ohio law was not urged by respondent in briefs; although the Tax Court's findings show a share issue to petitioner and the other organizers in 1942, and although no findings of fact were made regarding conformity of the issue to requirements of Ohio law (necessarily so, for the matter was not tried, and the record contains no evidence directed to that issue, and no evidence sufficient to support a finding of invalidity), the Tax Court relied as a supporting ground for its decision on an argument to the effect that the shares weren't issued in 1942 because they couldn't have validly been so issued under Ohio law. (Tr. pp. 46, 47.)

Reliance on this ground was improper, as a matter of procedure; in addition on the merits thereof the argument is incorrect as a matter of law.

Tax Court Rule 14 requires that "* * * The answer shall be so drawn as fully and completely to advise the petitioner and the Court of the nature of the defense. It shall contain a specific admission or denial

of each material allegation of fact contained in the petition and a statement of any facts upon which the Commissioner relies for defense or for affirmative relief * * *"

This rule was recently applied in *Sangstrom Hettler* (Feb. 28, 1951), 16 T.C. #65, pointing out that an issue must be raised by proper pleading, or at least by sufficient indication during the trial. See also *William F. Horsting* (1946), 5 T.C.M. 421; *Wentworth Manufacturing Co.* (1946), 6 T.C. 1201. This is obviously essential to fair judicial procedure, for as will be apparent from the slightest glance at the authorities, e.g., the two hundred or more pages devoted by Fletcher, 11 *Cyclopedia Corporations*, §§ 5182-5257, to the subject of consideration for shares and the effect of a purported issuance for unauthorized consideration, the subject is complex, and particular facts and circumstances are important.

The determination of an issue adversely to the taxpayer, partly on the basis of such an issue as to which he had opportunity neither to present evidence nor argument, cannot be justified.

It is petitioner's hope that an analysis of the complex law on this subject will not be necessary; on the basis of a reasonably comprehensive examination of the pertinent authorities, petitioner's counsel have concluded that the Ohio statutory provisions relied on by the Tax Court did not have the effect of preventing the shares from being validly issued in 1942, in accordance with the manifest intention of the parties.

Though shares so issued would in many circumstances be subject to attack by shareholders who did not knowingly acquiesce in the transaction, and by the corporation acting on behalf of such shareholders or of creditors, and although creditors, in the event of insolvency, might have been able to hold petitioner to payment in cash of the $100 per share established by the directors as the value and contribution to capital represented by the shares, in the circumstances of this case, as between petitioner and the corporation, and the other organizers and shareholders, the shares were, from the outset in 1942, validly issued to and outstanding in the ownership of petitioner.

Certainly the shares and the transactions in which they were issued, are not now subject to question in this entirely collateral proceeding.

Professor Ballantine, in his *Law of Corporations,* § 351, pp. 808-812, discusses statutes of the Ohio type and clearly indicates that they do not have the effect of invalidating shares issued for unauthorized consideration.

II.

THE SHARES CONSTITUTED INCOME TO PETITIONER IN 1942.

The purported factual basis for the conclusion that the shares did not constitute income for 1942 is that petitioner did not then become the "unrestricted owner" of the shares. Of course he did not become the unrestricted owner of the shares then; they were issued under a contract that required that they be

pledged, and they were pledged, pledged as security for the performance of the contract.

So, he didn't become the "unrestricted owner" in 1942. The fact that property *actually received* by a taxpayer is subject to restrictions limiting his ownership, use or control thereof, does not prevent it from being immediately taxable as income. *Soreng v. Commissioner* (C.C.A. 7th, 1946), 158 F. (2d) 340. Cf. *Standard Slag Co. v. Commissioner* (C.A.D.C. 1933), 63 F. (2d) 820.

An attempt has been made to discover the source of confusion underlying the Commissioner's case; it appears to arise from the failure of both Commissioner and Tax Court to appreciate fundamental distinctions between income in the form of money and income in the form of property other than money, and between constructive receipt of money (or perhaps in rare cases of other property) and actual receipt of property other than money.

If the income in question is cash, and it has not come into the taxpayer's possession, he has not actually received the only thing in issue—the money.

If, though not actually received by reduction to possession, the money is subject to the taxpayer's unrestricted control and domination, or applied for his benefit, it is not reasonable that taxation be postponed or prevented by the taxpayer's omission to collect it or reduce it to possession, and in such cases the money is immediately taxed under the doctrine of constructive receipt.

However, the doctrine of constructive receipt is intended to reach income actually available to the taxpayer, and is accordingly applied only to income which is unqualifiedly subject to his command—available to him without restriction.

Thus many of the cases relied on by the Tax Court hold that income in the form of money was not *constructively received* because it was subject to such restrictions that the taxpayer did not have command over it or the immediate right to reduce it to possession. *Marion H. McArdle* (1948), 11 T.C. 961; *E. P. Madigan* (1941), 43 B.T.A. 549; *International Mortgage and Investment Co.* (1937), 36 B.T.A. 187; *Preston R. Bassett* (1935), 33 B.T.A. 182; *Benjamin F. Patterson* (1930), 21 B.T.A. 8. (Cf. *Cleveland-Trinidad Paving Co.* (1930), 20 B.T.A. 772.)

But we are not dealing here with the question of whether or not the income in question was constructively received in 1942.

How does a taxpayer *actually receive* income in the form of shares in a corporation? How else but by the creation of the share contract with the corporation—by having the shares issued to him, and becoming the owner of such shares, and a shareholder in the corporation?

If these things occurred in 1942, *the shares were actually then received,* and the existence of restrictions which might, in the case of money, prevent application of the doctrine of *constructive* receipt, is of no consequence.

The distinction between income in stock and in money is illuminated, and the soundness of petitioner's position is demonstrated, by a comparison of *Luther Bonham* (1936), 33 B.T.A. 1100, affirmed *Bonham v. Commissioner* (C.C.A. 8th, 1937), 89 F. (2d) 725, and *Marion H. McArdle, supra,* heavily relied on by the Tax Court herein.

Luther Bonham, at 1105, 1106:

> "The only remaining question to be determined is whether or not the petitioner, being on a cash receipts and disbursements basis, received in the taxable year the 750 shares of the Northwest Bancorporation stock covered by paragraph 4 of the contract. If so, this stock, at $70 per share, must also be included in computing the gain recognized for the year 1929.
>
> "The petitioner contends that never at any moment until this stock was released to him in 1931 and 1932 did he receive it or have a right to receive it, and that under no circumstances did it constitute income to him in any prior year.
>
> "The contract between the parties best reflects the actual transaction. By its terms the petitioner and his wife disposed of 750 shares of bank stock and received therefor 2,250 shares of stock of the Northwest Bancorporation and $67,500 in cash. In section 4 of the contract, it appears that the company had questioned certain paper carried in the assets of the bank, and the 750 shares of stock were deposited with the company and were to be held by it until the actual work-out of these assets had been determined. According to the terms of the contract the peti-

tioner and his wife received the entire amount of the stock in the year 1929 and deposited the 750 shares as security for the representations made by them with reference to the assets of the bank. (Citations.) In the last two cases cited stock was sold for cash and it was pointed out in the opinions that the sellers did not receive in the taxable year the full amount of the purchase price, nor did they have the right to receive it. Payment of this balance was conditional and it was held that such balance did not constitute income until the events on which payment was conditioned were fulfilled. This case is different. Here the contract contained no condition whatever with reference to the payment of the full amount of the stock agreed upon. Even though the assets of the bank did not work out as represented, there was no right on the part of the seller to reduce the number or to take back any of the shares exchanged under the contract, but only a right to sell collateral to the extent required to make good the representations as to the bank assets. *Ownership of this stock had passed to the petitioner and he was exactly in the same situation as if other securities had been deposited in the place of the 750 shares of company stock.*"

In affirming the determination that the gain was taxable in 1929, the Eighth Circuit Court of Appeals said:

"* * * [the contract] required the issue of 750 shares of the Northwest stock; the 'deposit' thereof with that company until fulfillment of the conditions of Exhibit B; and the right to 'sell * * * on the market' such stock or parts thereof

as necessary to make good default in such fulfillment. Such requirements are consistent only with the passing of title to the stock and its pledge as guarantee of fulfillment of the conditions of Exhibit B. The stock was issued, the title passed then to petitioner, and the stock was retained as a pledge. The circumstance is unimportant that the stock was not physically delivered to petitioner and then redelivered by him to the company upon the pledge. In so far as strict legal right under the contract is concerned, he might have demanded such delivery and have made such redelivery. The actual handling through issuance and retention on the pledge was merely a matter of convenience not of legal right."

The court, recognizing that the transaction could have been set up so as to postpone realization of the gain, by use of a contract to issue the shares in the future instead of a present issue and pledge back as security, pointed out that where such alternatives are available, for example, as to the time of passage of title to stock, both taxpayer and government are bound by what was done, and the tax consequences are not affected by what might have been done.

In the present case, as in the *Bonham* case, the shares were issued and pledged at the outset of the transaction.

In the *McArdle* case, *supra,* in which it was held that payments in the form of cashiers' checks representing part of the purchase price of stock, which were, pursuant to agreement, delivered to a seller,

endorsed by him, and returned to the buyer as security against contingent liabilities, did not represent income to the taxpayer in the year so delivered and endorsed, the Tax Court discussed the *Bonham* case, as follows:

> "The parties apparently recognize that *Luther Bonham,* 33 B.T.A. 1100 * * *, affirmed 89 Fed. (2d) 725 is distinguishable, at least they have not cited it. There the taxpayer received some stock which he was required immediately to put up as collateral. But it was his stock and he had the rights of ownership of it such as the voting rights, dividend rights, the right to any increase in value, and the right to have that particular stock returned to him when the collateral was no longer required."

If any doubts remain as to the correctness of petitioner's position, they should be allayed by the decision of this court in *Chaplin v. Commissioner* (C.C.A. 9th, 1943), 136 F. (2d) 298, reversing *Charles Chaplin* (1942), 46 B.T.A. 385.

The principal issue was whether Charles Chaplin, one of the organizers of United Artists Corporation, realized income in the form of shares of the corporation in 1935 when they were delivered to him by an escrow holder pursuant to instructions from the corporation that Chaplin had satisfied his obligations under the agreement, as modified, under which the shares were originally issued.

This court examined the pertinent documents and considered the conduct of the parties.

It quoted and applied the following rule (p. 301):

> "It is elementary that title passes when the parties intend that it shall pass and such intention is to be gathered from the contract and conduct of the parties."

After analyzing the facts in the light of this rule, the court concluded (p. 302):

> "We consider the agreement of 1924 controls the prior agreements, none of which explicitly defined the place of ownership. Under that agreement the shares are owned by the artist as appeared on the certificates held by the escrow agent, whose only power, like that of a pledgee, was to transfer them to United if Chaplin failed to perform his contract. One nonetheless owns personal property because held by another to insure the performance of a contract.
>
> "We hold that Chaplin owned the common shares at least since 1928, when he received and endorsed the certificates thereafter held by O'Brien; that the Tax Court erred in including their value in his 1935 income."

Though the present case does not exactly parallel the *Chaplin* case as to all material facts, the similarity is striking, and the ultimate fact that the parties intended that title to the shares pass at the time of issuance, endorsement, and delivery as security, rather than on their release from deposit as security, is identical.

The observation of the learned Tax Court judge (Tr. p. 49) in connection with the discussion of

Anthony Schneider (1926), 3 B.T.A. 920, that *Charles Chaplin, supra,* was "reversed on another issue" by this court, is indicative of confusion in the analysis of applicable law and authority.

On the issue of the time of realization of income in the form of shares of stock, the Board of Tax Appeals decision in *Charles Chaplin,* conformed to the views of the board in *Anthony Schneider,* and, on precisely this issue, it was reversed.

The Tax Court's asserted difficulty in understanding the pertinency of this court's decision in the *Chaplin* case (Tr. p. 49) is surprising. Some point is made that the consideration for the shares was to be property in the form of photoplays, rather than the personal services of Charlie Chaplin. Of course there is more to a finished photoplay than the personal services of the star, but obviously the real consideration was his unique personal talent—or perhaps his contract would have been equally performed had he delivered a movie starring King Kong!

In any event the nature of the consideration rendered or to be rendered in exchange for stock or the time of rendering it is not material. Money or property constituting income is taxable when received, even though in exchange for services to be rendered in the future. *Allen v. Commissioner* (C.C.A. 4th, 1939), 107 F. (2d) 151 (stock for future legal services; cash basis taxpayer); *Your Health Club, Inc.* (1944), 4 T.C. 385 (money received for club services to be furnished in future; accrual basis taxpayer).

Another point made in the opinion is that petitioner did not prove receipt of dividends, or exercise of voting rights. (Tr. pp. 43, 50.) He proved issuance and ownership of the stock, from which dividend and voting rights follow, absent proof to the contrary. Respondent had no evidence or cross-examination questions on these issues.

The underlying confusion between property and money as income and between actual and constructive receipt is again demonstrated by the Tax Court's observations on the dividend issue involved in the *Chaplin* case. (Tr. p. 50.)

Of course cash dividends paid to the escrow holder and subject to the restrictions of the escrow were not sufficiently subject to Chaplin's control and domination to be substantially equivalent to cash reduced to his possession, and therefore were not constructively received by Chaplin prior to actual distribution to him, and this court so held. This is not inconsistent with, and indeed has nothing to do with, the proposition that shares of stock issued and deposited as security are income when originally issued.

Reference may also be made to the following additional authority supporting petitioner's contentions. Income arising by virtue of the creation of the shareholder relationship is realized in the year the relationship is created, despite failure to issue certificates, *Bradbury v. Commissioner* (1931), 23 B.T.A. 1352; and regardless of the fact that ownership is restricted by a security device, e.g., an escrow, *Carnahan v. Commissioner* (1930), 21 B.T.A. 893; *Cohu v. Com-*

missioner (1947), 6 T.C. 796; cf. *Moore v. Commissioner* (C.C.A. 7th, 1941), 124 F. (2d) 991.

COMMENT ON OTHER AUTHORITIES.

The cases of *Schneider v. Duffy* (D.C.N.J. 1930), 43 F. (2d) 642, relied on by petitioner, and *Anthony Schneider* (1926), 3 B.T.A. 920, relitigated with the same result reached by the Tax Court in *Glen v. Bowers* (D.C.N.Y., S.D., 1932) (no opinion); affirmed without opinion (C.C.A. 2nd, 1933), 65 F. (2d) 1017, cert. den. (1933), 290 U.S. 681, relied on by respondent and by the Tax Court, considered identical contracts and fact situations, with opposite, and of course irreconcilable, results. Petitioner submits that the opinion in *Schneider v. Duffy,* shows much superior factual analysis and legal reasoning than the Board's opinion in *Anthony Schneider.*

Petitioner has carefully analyzed the remaining cases relied on or cited by the Tax Court involving income in the form of stock which can be regarded as remotely in point (cf. *Charles F. Mitchell* (1941), 45 B.T.A. 300; *K. E. Merren* (1929), 18 B.T.A. 156) and finds them uniformly distinguishable, none involving an actual stock issue and pledge back as security.

The remaining cases involving income in the form of stock are, in the order cited in the opinion: *Charles F. Mitchell* (1941), 45 B.T.A. 300 (Tr. p. 42); *Phillip W. Haberman* (1934), 31 B.T.A. 75, affd. 79 F. (2d) 995 (Tr. p. 44); *Lyle H. Olson* (1931), 24 B.T.A. 702

(aff'd. C.C.A. 7th, 1934), 67 F. (2d) 726, cert. den. 292 U.S. 637 (Tr. p. 44); *Adolph Zukor* (1935), 33 B.T.A. 324 (Tr. p. 45); *Roscoe H. Aldrich* (1926), 3 B.T.A. 911 (Tr. p. 45); *Charles F. Pearce* (1927), 6 B.T.A. 450 (Tr. p. 45); *James R. Lister* (1926), 3 B.T.A. 475 (Tr. p. 45); *K. E. Merren* (1929), 18 B.T.A. 156 (Tr. p. 49); *Albert R. Erskine* (1932), 26 B.T.A. 147 (Tr. p. 49).

The following noted points of distinction are illustrative only. Detailed analysis of the cases would require an extensive, expensive, and seemingly unwarranted addition to the brief.

In most of the cases, time of realization of income was not the principal issue, *Philip W. Haberman, Lyle H. Olson, Albert R. Erskine,* or was not even in issue, *Adolph Zukor, Roscoe H. Aldrich.* (Cf. *Charles F. Pearce,* in which the amount of a stock bonus was not determinable until after the taxable year in question.)

The *Haberman* and *Erskine* cases involved *rights to purchase* stock in the future, and thereupon become a stockholder.

In *Lyle H. Olson,* estoppel was relied on, the taxpayer having failed to report the shares as income in the year he argued to be proper.

In *James R. Lister,* the contract was regarded as contemplating a future transfer of stock, conditioned on completion of three years' services, and apparently no contention was made that the income was realized at the time the contract was executed.

Petitioner respectfully submits that the decision of the Tax Court herein is clearly erroneous, and should be reversed, with directions to enter decision for the petitioner.

Dated, San Francisco, California,
April 9, 1951.

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No. 12,803

In the United States Court of Appeals for the Ninth Circuit

FRED C. HALL, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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FILED

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BRIEF FOR THE RESPONDENT

OPINION BELOW

The findings of fact and opinion of the Tax Court (R. 33-50) are reported at 15 T. C. 195.

JURISDICTION

This petition for review (R. 52-58) involves federal income taxes for 1943 and 1944. On October 26, 1948, the Commissioner of Internal Revenue mailed to the taxpayer notice of a deficiency in the total amount of $1,567.63. (R. 5.) Within ninety days thereafter and on November 23, 1948, the taxpayer filed a petition with the Tax Court for a redetermination of that deficiency under the provisions of Section 272 of the Internal Revenue Code. (R. 5-8.) The decision of the Tax Court sus-

taining the deficiency was entered August 31, 1950. (R. 51.) The case is brought to this Court by a petition for review filed November 24, 1950 (R. 58-59), pursuant to the provisions of Section 1141 (a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

QUESTION PRESENTED

Whether the Tax Court correctly determined that taxpayer is taxable in 1943 and 1944 on the value of shares of stock delivered to him in those years upon his performance of personal services pursuant to an executory contract rather than in 1942 when the shares were issued in his name.

STATUTE AND REGULATIONS INVOLVED

The applicable provisions of the statute and Regulations involved are set forth in the Appendix, *infra.*

STATEMENT

Insofar as pertinent to the issue here involved the facts as found by the Tax Court (R. 35-40) are as follows:

Taxpayer was a resident of Cleveland, Ohio, from 1936 to 1945. During the years in question, he reported his income on the cash receipts and disbursement basis. From 1936 to November, 1942, he was employed by the American Coach and Body Company in Cleveland. Prior to leaving the company in November 1942, he was the manager of its jig and fixture division. (R. 35.)

In November, 1942, the Ohio Aircraft Fixture Company (hereinafter referred to as "Company") was incorporated under the laws of Ohio for the purpose of acquiring and operating the jig and fixture division of the American Coach and Body Company. The Company was organized by taxpayer and three associates,

Warnsman, Fortney, and Wilson. Taxpayer purchased one share of stock from the Company at this time, and each of the other three organizers purchased ten shares of stock. The price paid for the stock was $100 per share. The $3,100 thus raised was adequate working capital for the needs of the Company which was organized to take over and operate a business which had valuable war production contracts and other assets sufficient for its operations. (R. 35.)

The purchase of the jig and fixture division was consummated in November, 1942, and the Company thereby acquired, on very lenient terms, a going concern, including its personnel, equipment, and valuable war production contracts. (R. 35-36.)

On November 25, 1942, taxpayer entered into an employment contract with the Company. This contract provided (36-38):

Employment Contract

* * * * *

The Parties hereto mutually agree as follows:

1. That the First Party [the Company] hereby hires the Second Party [petitioner] and the Second Party agrees to work for First Party in the capacity of Manager of the Service Engineering Department, in charge and responsible for all sales and advertising, formulating and figuring all selling prices in co-operation with the shop engineering and cost departments and to assist the factory manager in scheduling and planning production in First Party's business of general manufacturing, particularly aircraft, jigs and fixtures for a period of two (2) years, commencing on the 15th day of November, 1942 and ending on the 14th day of November, 1944.

2. Said Second Party shall at all times during such term of employment give his full attendance

and to his best endeavors and to the utmost of his skill and abilities exert himself for the profit, benefit and advantage of said business and perform such duties in said capacities as shall be required of him from time to time by First Party.

3. First Party shall pay the Second Party for his services hereunder as salary and compensation at the rate of One Hundred and Twenty-five ($125.00) per week in addition to ten per cent (10%) of the profits over $5,000.00 before Federal Taxes and after providing for all known reserves for contingencies: of the salary $100.00 is to be paid in cash each week, $25.00 and the said ten per cent, at the option of the Directors of the Company, may be paid in cash or in stock of the Company and shall be payable on or before January 15th of each year and shall cover the preceding year.

4. It is agreed by and between the parties that in case of illness, the base salary shall continue at full rate for six (6) months, half rate for a consecutive six (6) months and quarter rate for the balance of the term of the contract in excess of two six months periods, the additional salary, if any remaining the same. First Party through its Board of Directors, if it deems advisable, may demand Certificate of Inability to perform on account of illness from one or more reputable physicians.

5. First Party shall issue fifty (50) shares of stock of the Company in consideration of the signing of this employment contract and to carry out certain contracts necessary in the prosecution of the war. Two certificates are to be issued. Each to be for twenty-five shares and endorsed in blank. They are to be deposited with the Treasurer of the Company for the faithful performance of his contract. One certificate for twenty-five shares to be delivered on December 1, 1943, and the other certificate for twenty-five shares to be delivered on December 1, 1944, on the order of the Board of Directors.

6. Second Party agrees that during the life of this contract he will not engage in any manner either directly or indirectly engage [*sic*] in any other gainful occupation without consent of the Board of Directors; and shall further be directly responsible to the Board of Directors of the Company for the operation of his departments and said Directors shall from time to time determine the operating policies of these departments.

7. It is agreed by and between the parties that this contract will be considered performed on death of the Second Party.

Each of the other three organizers entered into similar employment contracts with the Company. (R. 38.)

Pursuant to the employment contract, two stock certificates, each representing 25 shares of no-par value stock, were issued in taxpayer's name in the latter part of 1942. He endorsed each stock certificate in blank and deposited it with the treasurer of the Company. Certificates representing fifty shares of stock similarly were issued in the names of each of the other three organizers who endorsed the certificates and deposited them with the treasurer of the Company. (R. 38.)

Prior to the issuance of the stock, the board of directors of the Company placed a value of $100 per share upon each of the shares of no-par value stock, which represented the fair market value of each share. The total number of shares of stock originally issued by the Company was 231. Of this number, 200 shares were issued to the organizers upon their execution of the employment contracts, and 31 were issued to the organizers upon the payment of $100 per share. (R. 38-39.)

Taxpayer began work for the Company on November 15, 1942. During 1943 taxpayer received $6,500 as his base salary from the Company for his services as manager of its service engineering department, and addi-

tional compensation of $3,515 as his share of the profits above $5,000. In December 1943, one of the stock certificates representing 25 shares of stock which had been issued in taxpayer's name was delivered to him by the treasurer of the Company on the order of the board of directors. (R. 39.)

During 1944 taxpayer received $6,500 as his base salary from the Company and additional compensation of $3,290 as his share of the profits above $5,000. In December, 1944, the second stock certificate representing 25 shares of stock which had been issued in taxpayer's name was delivered to him by the treasurer of the Company on the order of the board of directors. (R. 39.)

In September, 1945, taxpayer severed his connection with the Company and sold his shares of stock for $150 per share. (R. 39.)

On the basis of the foregoing, the Tax Court concluded (R. 40) that the taxpayer became the unrestricted owner of 25 shares in 1943 and the other 25 shares in 1944, and hence was taxable on their value in those years, rather than in 1942 when the shares were issued in taxpayer's name.

SUMMARY OF ARGUMENT

The taxpayer in the instant case, pursuant to an employment contract, received for the first time without restriction 25 shares of stock in 1943 and 25 in 1944. It is the Commissioner's contention that the fair market value of these shares constituted income to the taxpayer in those years rather than in 1942 when the shares were endorsed by him and deposited with the treasurer of the Company. The Tax Court so held, and its finding is not only not clearly erroneous but is abundantly supported by the record.

Prior to their receipt in 1943 and 1944, the taxpayer

could not sell these shares, nor transfer them in any way. There is no showing by the taxpayer, upon whom is the burden of proof, as to whether dividends were paid on the shares or as to who voted the shares. Actually, on the record presented to this Court, there is no showing that the taxpayer exercised any control over the deposited stock; hence, the Commissioner's determination should not be overturned.

Moreover, the taxpayer's contention that the mere signing of the employment contract was sufficient consideration for the transfer of the shares is contrary to the laws of Ohio, under which they were issued. Further, it should be emphasized that the mere fact of signing the employment contract had no value as such; it was the rendition of services for which the contract was made.

If the taxpayer had received the shares outright in 1942 there would be no problem. The instant proceeding has arisen only because the taxpayer did not receive the shares in 1942 unrestricted and subject to his control; he so received them in the later years and that is when the tax should be assessed.

ARGUMENT

The Tax Court Correctly Held That the Value of the Shares of Stock Was Includible in Taxpayer's Income in 1943 and 1944 at the Time When He Received Them Unconditionally Rather Than in 1942 When They Were Issued in His Name

A. *The applicable principles of law*

Since the nature of income is fluid, not static, the imposition of an income tax requires that points of time be fixed between which it is to be measured for taxation purposes. Hence, as the Supreme Court said in *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, 363:

> All the revenue acts which have been enacted since the adoption of the Sixteenth Amendment

> have uniformly assessed the tax on the basis of annual returns showing the net result of all the taxpayer's transactions during a fixed accounting period, either the calendar year, or, at the option of the taxpayer, the particular fiscal year which he may adopt.

By this means the Government is assured of payments at regular intervals necessary for its support and only by such a system is the income tax capable of practical administration, for, as the Court further said in the cited case (p. 365):

> The Sixteenth Amendment was adopted to enable the government to raise revenue by taxation. It is the essence of any system of taxation that it should produce revenue ascertainable, and payable to the government, at regular intervals. Only by such a system is it practicable to produce a regular flow of income and apply methods of accounting, assessment, and collection capable of practical operation.

Thus, Section 42 of the Internal Revenue Code, Appendix, *infra,* sets forth the general rule that income for the purposes of the federal tax is to be included within the year in which it is received by the taxpayer, unless he reports his income by an accounting system other than the cash basis. Cash basis taxpayers are considered to be taxable as of the date of realization of income. This means that the taxable occurrence is the receipt of cash or its equivalent.

Working in mitigation of the requirement of actual receipt for tax liability on the cash basis is the doctrine of constructive receipt. This principle, rooted in Treasury Regulations 111, Section 29.42-2, Appendix, *infra,* treats as taxable any sum which is subject to the unqualified command of the taxpayer, regardless of the fact that it has not fallen into his physical possession.

However, in order that an amount be recognized as constructively received it must be clear that there is no restriction upon the crediting of the taxpayer; availability must be unhampered. *Old Colony Trust Co.* v. *Commissioner,* 22 B. T. A. 1062. This is exemplified in the rule in compensation cases that the doctrine will not be invoked unless the employer is solvent. *Northern Trust Co.* v. *Commissioner,* 8 B. T. A. 685.

This doctrine is applied in special circumstances.[1] But its application is limited to situations where the money or property was available to the taxpayer without restriction and the failure to receive it resulted from the exercise of his own choice under circumstances where he had control of the right to receive the income in a certain year. *Aramo-Stiftung* v. *Commissioner,* 172 F. 2d 896 (C. A. 2d); *Hedrick* v. *Commissioner,* 154 F. 2d 90 (C. A. 2d), certiorari denied, 329 U. S. 719. In general it may be said income should not be construed to have been received prior to the date of actual receipt except where a taxpayer turns his back upon income or does not choose to receive income which he could have if he chose.

As the Tax Court stated in *Gullett* v. *Commissioner,* 31 B.T.A. 1067 (Acquiescence, XIV-1 Cum. Bull 9 (1935)) (p. 1069):

> From the decisions in cases previously arising upon this issue, * * * the principles to be applied in deciding the case at bar upon its own facts have been established. It is clear that the doctrine of constructive receipt is to be sparingly used; that amounts due from a corporation but unpaid, are not to be included in the income of an indi-

[1] Taxpayer argues (Br. 24) that the doctrine of constructive receipt is not involved herein, but actual receipt. The important factor, however, in either case is whether or not restrictions prevent a receipt of any kind. The same factors preventing actual receipt prevent constructive receipt.

vidual reporting his income on a cash receipts basis unless it appears that the money was available to him, that the corporation was able and ready to pay him, that his right to receive was not restricted, and that his failure to receive resulted from exercise of his own choice.

Choses in action that have a readily realizable market value are generally included as income for the year in which received. *Old Colony Trust Co.* v. *Commissioner,* 59 F. 2d 168 (C. A. 1st); *Commissioner* v. *Scatena,* 85 F. 2d 729 (C. A. 9th). However, shares of stock received as payment for services, subject to the qualification that they be held and not transferred for a stated period, are not income until the end of that period. *Propper* v. *Commissioner,* 89 F. 2d 617 (C. A. 2d). Nor are blocked marks collected in Germany but incapable of being cashed outside that country taxable income (*International Mortgage & Investment Corp.* v. *Commissioner,* 36 B.T.A. 187), or shares of stock credited each to an employee to become unconditionally his at the end of five years' service (*Olson* v. *Commissioner,* 67 F. 2d 726 (C. A. 7th), certiorari denied, 292 U. S. 637) income until the end of that period.

Whether or not there had been a constructive receipt is essentially a question of fact. *Avery* v. *Commissioner,* 292 U. S. 210; *Adams* v. *Commissioner,* 20 B.T.A. 243, affirmed, 54 F. 2d 228 (C. A. 1st).

B. *The conclusion of the Tax Court that the shares of stock constituted income to the taxpayer in 1943 and 1944 is not only not clearly erroneous but is abundantly supported by the record*

In the instant case, the taxpayer in 1942 made a contract of employment with the new corporation whereby 50 shares of its stock were to be provisionally issued to

him. (R. 36-38.) By the express proviso of the contract, the shares were not to be issued to the taxpayer absolutely but were to be issued to him and immediately endorsed in blank and given to the treasurer of the corporation, by whom they were to be held until December 1943 and December 1944, when upon order of the board of directors they were to be delivered to him. (R. 37-38.) The 1942 issuance was expressly stated to be only provisional. (R. 37-38.) He was to have no control over the shares while they were held by the treasurer. Indeed, his own understanding of the purpose of the arrangement was frankly stated to be that the corporation would itself be able to realize on them in event of his default on his employment. (R. 25-26.) On the basis of these facts the Tax Court held (R. 50) that the fair market value of the shares of stock was income to the taxpayer at the time (1943 and 1944) that they were made subject to his unfettered command and control.[2] This conclusion should stand unless it is "clearly erroneous." *United States* v. *Gypsum Co.*, 333 U. S. 364, 395.

Initially it should be noted that the taxpayer, upon whom was the burden of proof, failed to adduce several items of evidence at the Tax Court trial which are relevant to a decision of the issue in this case. It is not shown in the evidence as to whether or not dividends were ever declared by the Ohio Aircraft Fixture Company, and if so, whether these shares, being treasury

[2] This situation is to be compared to a sale in form only to an employee. If it is shown that the parties never intended the employee to furnish any part of the purchase price of the stock from his own funds, the company is entitled to a deduction equal to the market value of the stock determined as of the date the stock is transferred to the employee as the employee's property, i.e., the time of the final delivery to the employee. See *Hudson Motor Car Co.* v. *United States*, 3 F. Supp. 834 (C. Cls.); *United States Steel Corp.* v. *Commissioner*, 2 T. C. 430.

shares, were treated differently from the other shares. Neither is it shown as to whether or not any of the shares in question were ever voted, and if so, by whom. This is significantly lacking in the record.

There was no delivery of the certificates to the taxpayer to suffice for purposes of the income tax. He only endorsed them and handed them back to the Company, until such time as the Company had agreed to turn them over to his control. He could not transfer them; he could not sell them. (R. 43.) As stated, *supra,* there is no evidence as to whether he could vote the shares or had the right to receive the dividends. In short, on this record it is manifest that the Tax Court was clearly justified in coming to the conclusion that these shares did not belong to the taxpayer until 1943 and 1944. Contrary to the argument of taxpayer (Br. 10), he could clearly resist a tax in the year in which such a provisional delivery was made, for he had in fact received nothing. His momentary holding of them for endorsement is not a receipt by him. The mere issuance by the corporation does not give him income any more than if the corporation had merely promised to issue the shares in later years; for by the provisional issuance he did not receive unfettered ownership and control.

Moreover, as pointed out by the Tax Court (R. 46-47), the taxpayer's contention that the mere signing of the contract was sufficient consideration for the transfer of the shares is contrary to the laws of Ohio. Section 8623-22, Page's Ohio General Code, states:

> *Payment for shares.* * * * shares shall be issued only * * *, or for labor or services actually rendered to the corporation.

Thus, under the prevailing local statute, the taxpayer could not become the owner until the services had been

performed, which in the instant case was 1943 for the first 25 shares and 1944 for the other 25 shares.

Taxpayer contends (Br. 13-15) that paragraph Five of the Employment Contract shows that the shares of stock were transferred in consideration of the mere signing of the contract; it is alleged that these shares did not constitute additional compensation. However, the Tax Court, in dismissing this argument, stated (R. 46):

> But the Company was contracting for petitioner's services, not for his promise. The bare promise without the services had no value. The services called for by the contract were not performed until 1943 and 1944, in each of which years a certificate for 25 shares was delivered to petitioner for the services which he had rendered.

Thus the facts herein clearly take the case out of the scope of actual receipt and the constructive receipt doctrine as far as the year 1942 is concerned. The shares were not set apart and subjected to taxpayer's unrestricted control in that year.

It should be emphasized that if these shares had been given to the taxpayer in 1942 with no restrictions, then this case would not have arisen. The problem is only presented because the taxpayer did not receive the shares—he had to endorse them and return them to the Company. Hence, it was the Company and not the taxpayer that had control of the shares. See *McArdle* v. *Commissioner,* 11 T. C. 961.

Other and more formal restrictive devices have caused similar tax postponement. Where the buyer retained or placed in escrow part of the compensation to guarantee himself against loss, that amount has been held not to be income to the seller until actually received. *Big Lake Oil Co.* v. *Commissioner,* 95 F. 2d 573 (C. A. 3d), certiorari denied, 307 U. S. 638. And in

Stoner v. *Commissioner,* 79 F. 2d 75 (C. A. 3d), certiorari denied, 307 U. S. 611, the seller, pursuant to agreement, deposited part of the consideration in trust pending final determination of tax liability on the purchased business, and was held to have received no income until the retained consideration was released. See The Effect of Escrow Arrangements on Federal Income Tax Liability, 59 Harv. L. Rev. 1292 (1945-1946);[3] *Lavery* v. *Commissioner,* 158 F. 2d 859 (C. A. 7th).

Haberman v. *Commissioner,* 79 F. 2d 995 (C. A. 2d), presents a more extreme situation than the instant case. In that case the taxpayer received fully issued and paid-up shares from the employer company as compensation, endorsed them, and then deposited them with the company to secure a loan for the full purchase price of the shares. He repaid the loan and received the shares. It was held that the taxpayer received the compensation as income in the years in which the stock was finally transferred to him.

Relative to his understanding of the provision of the employment contract that required him to endorse the certificates and return them to the treasurer of the Company, the taxpayer testified (R. 26):

> The Witness: Well, I would believe that if I failed to perform under the contract, owing to the

[3] In the situation where the escrow agent is to deliver to the seller only after a certain date, the general principles are that the gain should be reported on ultimate receipt unless that receipt is so likely that the taxpayer may fairly be charged with an immediate, measurable economic benefit. The ultimate recipient's degree of control over the use of the deposited item and the receipt of interim income from it, of course weigh heavily in favor of immediate taxability. *Bassett* v. *Commissioner,* 33 B. T. A. 182, affirmed *per curiam,* 90 F. 2d 1004 (C. A. 2d). But where there is a definite statement that ultimate receipt must take place, if at all, in a subsequent taxable period, and the taxpayer neither receives interim income as it accrues nor has control of the deposited corpus, the argument for postponing taxability is much stronger. *Commissioner* v. *Tyler,* 72 F. 2d 950 (C. A. 3d).

responsibility that the company had to complete those contracts I would need to be replaced, and if there were expense or damages involved in replacing me or because I didn't complete the contract, those damages could be recovered from the value of the stock that they were holding that had been issued to me.

On the basis of this testimony the taxpayer seeks to argue (Br. 18-19) that these shares were merely on deposit with the Company. However, emphasis on this point is misplaced because as indicated by the cases, *supra,* if a deposit of any nature is as restricted as the one in the instant case, then it does not constitute income to the transferee.

CONCLUSION

The decision of the Tax Court is in accordance with law. It is not clearly erroneous but on the contrary is fully supported by the facts of record. Therefore it should be affirmed.

Respectfully submitted,

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MAY, 1951.

APPENDIX

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(26 U.S.C. 1946 ed., Sec. 22.)

SEC. 42 [as amended by Section 114 of the Revenue Act of 1941, c. 412, 55 Stat. 687, 697]. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

(a) *General Rule.*—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

(26 U.S.C. 1946 ed., Sec. 42.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.42-2. *Income Not Reduced to Possession.*—Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then actually reduced to possession. To constitute receipt in such a case the income must be credited or set apart to the taxpayer without

any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and must be made available to him so that it may be drawn at any time, and its receipt brought within his own control and disposition. A book entry, if made, should indicate an absolute transfer from one account to another. If a corporation contingently credits its employees with bonus stock, but the stock is not available to such employees until some future date, the mere crediting on the books of the corporation does not constitute receipt.

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No. 12,803

IN THE

United States Court of Appeals

For the Ninth Circuit

FRED C. HALL,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Review of a Decision of the Tax Court of the United States.

PETITION FOR A REHEARING.

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FILED

MAR 28 1952

PAUL P. O'BRIEN
CLER

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PETITION FOR A REHEARING.

To the Honorable William Denman, Chief Judge, and to the Honorable Associate Judges of the United States Court of Appeals for the Ninth Circuit:

Fred C. Hall, Petitioner in the above cause, hereby petitions this Honorable Court for a rehearing herein and a reconsideration of its affirmance of the Tax Court, per curiam filed herein on February 29, 1952.

The rehearing is sought on the following grounds:

1. The Tax Court decision herein is irreconcilable with this Court's decision in *Chaplin v. Commissioner* (C.C.A. 9th, 1943), 136 F.(2d) 298.

This Court's per curiam affirmance in the instant case creates a conflict in the decisions of this Circuit

and leaves a rule of law of great importance to practitioners in a highly unsettled state.

2. In view of the determination by this Court that the validity of the stock under Ohio law was not properly before the Tax Court, the issue here presented is merely the legal effect of facts established by uncontradicted and unimpeached testimony and by documentary evidence of unquestioned validity. In the absence of conflicting testimony and in the absence of impeaching evidence or factual circumstances conflicting with the testimony, this Court should determine *as a matter of law* whether the ultimate conclusion of the Tax Court is fairly supported by the record, whether that determination is characterized as legal, factual or mixed. If the *Chaplin* case, cited supra, is to be repudiated, the moving considerations should be stated. If it is to be distinguished, any valid distinguishing factors should be made explicit, rather than being concealed in the misty shroud of per curiam affirmance of a foggy decision.

3. The documents and testimony introduced in this case are certainly sufficient to establish prima facie that the stock was issued to Petitioner in 1942 and pledged back by him to the corporation. If the evidence on this subject does not compel such conclusion, it is unquestionably sufficient to overcome the presumptive correctness of the Commissioner's contrary determination, thus rendering the matter one for decision on the evidence.

The evidence consists of the employment contract and Petitioner's uncontradicted, unimpeached testi-

mony consistent with all circumstances revealed by the record.

Petitioner most emphatically urges that a prima facie case is thus made out requiring the Commissioners to proceed with rebutting evidence or destructive factual analysis, neither of which burdens has in any sense been met.[1] It is therefore, as a matter of law, established that the stock was issued in 1942 and pledged back to the corporation in that year. It cannot be maintained consistently with *Chaplin v. Commissioner,* and *Luther Bonham* (1936) 33 B.T.A. 1100, affirmed *Bonham v. Commissioner* (C.C.A. 8th, 1937), 89 F.(2d) 725, cited and discussed in Petitioner's Brief at pages 25 through 30, that such transaction does not constitute the realization of income in 1942. To distinguish this case on so-called "factual" grounds in the face of a record free of substantial factual conflict is to draw a distinction without a difference.

4. The result of this Court's affirmance of the Tax Court decision in this case is a reversion to the legislatively repudiated Dobson rule[2] under which, if sufficiently confused, a Tax Court decision would not be reversed no matter how erroneous. The Tax Court decision is infected with clear legal and factual errors so inextricably interwoven into the fabric of the

[1]Cf. *Grace Brothers v. Commissioner of Internal Revenue* (C.C.A. 9th, 1949), 173 F.(2d) 170.

[2]*Dobson v. Commissioner* (1943), 320 U.S. 489; I.R.C. § 1141, as amended by P.L. 773, § 36, 80th Cong., 2nd Session, was intended to "[remove] all traces of the Dobson decision". (From House Debate, as reported by 1952 Prentice Hall Federal Tax Service, Par. 21,820.)

decision that when such errors are removed the remains are adequate to support no conclusion whatsoever.

In brief support of this position reference may be made to the following:

(a) The erroneous reliance upon the supposed effect of Ohio corporation law (Tr. pp. 46 and 47).

(b) Apparently regarding the time of rendition of services as controlling the time of realization of income (Tr. p. 46) despite the prior correct statement of the law that time of receipt controls regardless of time of rendition of services (Tr. p. 42).

(c) The conclusion, apparently on the basis of the Court's views as to how things ought to be, despite a record entirely to the contrary, that the stock was issued entirely or primarily for services to be rendered in the future rather than as consideration for Petitioner's participation in the new venture (Tr. p. 46; Petitioner's Brief pp. 13 through 20).

(d) The Tax Court's cavalier disregard of fundamental principles of corporation and securities law in its statement (Tr. p. 43) that Petitioner had no dominion or control over the shares and could not sell them prior to 1943 and 1944; indeed this disregard of such legal fundamentals permeates and invalidates the entire decision.

(e) The Tax Court's failure to make any findings on the vital questions of share issue and pledge and the making of purported ultimate findings that the petitioner "became the unrestricted owner . . . in 1943

[and 1944] in exchange for services which he rendered to the company [in such years]" which purported findings serve rather to conceal than disclose the factual basis for the Tax Court's determination.

(f) The Tax Court's statement (Tr. p. 43), erroneous if relevant, that there is no evidence as to the company's capital structure, its assets and liabilities, and who dictated its policies. The record shows without dispute or contradiction that petitioner was one of four organizers of the venture; it shows exactly what stock was issued, and for what consideration, (Eg. Tr. p. 21) and all conceivably relevant material regarding control, capital structure, and asset and liability position, is contained in or inferrable from these facts. The fair market value of $100.00 per share in 1942 was not in issue (Tr. p. 12) and the ultimate selling price of $150.00 per share was established. (Tr. p. 20.) The possible relevance of evidence on these points is not disclosed; such references in the Tax Court's opinion apparently are intended only to suggest that the taxpayer did not make a sufficiently full factual development to earn a favorable decision.

But the record shows fully, clearly, and beyond a doubt, that the taxpayer presented a full and fair disclosure of facts more than sufficient to establish prima facie the issuance of the stock to him in 1942 and the pledge thereof to the corporation as security for the performance of contractual obligations. The petitioner fully and fairly answered all questions of Government counsel as well as the rather extensive

questions of the Tax Court. Under such circumstances reliance on the absence of matters of evidence referred to in the Tax Court opinion (Tr. p. 43, First Paragraph) is ridiculous, unfair, and contrary to recognized standards as to what constitutes a prima facie sufficient showing.

(g) Though there is more merit to the Tax Court's references to the absence of evidence on dividend and voting rights, much the same observations are soundly applicable. From a showing of share issue—share issue at an undisputed fair market value (Tr. p. 12)—and pledge of the shares, *share ownership together with incident rights follows as a matter of law,* (see discussion in Petitioner's Brief, pp. 8-11, and authorities there cited) absent some showing to the contrary. If after the prima facie showing of share issue and ownership made by petitioner, opposing counsel or the Tax Court were in doubt regarding dividend and voting rights, inquiry could have been made. With the showing of share issue and ownership necessarily implicit in this record under a proper appreciation and application of principles of corporation law, the Tax Court's adverse conclusions with regard to dividends and voting rights are not supported by anything in the record, but rest entirely on extrajudicial considerations.

The taxpayer's burden of proof can only be to present a legally sufficient case and meet conflicting evidence, if any. The decision herein would impose not only that burden of proof but the further require-

ment of negativing all possible unfavorable inferences which could be drawn from the absence of any conceivably material items of evidence. The imposition of such a burden of proof is arbitrary, unfair, and contrary to law.

5. The decision herein abandons the clear, sound, simple and predictable intent rule[3] of the *Chaplin* case, cited supra, and replaces it with a rule which is no rule at all but which permits the Tax Court to impose taxes, not on the basis of what was done as shown by evidence judicially adduced, but rather on the basis of what it thinks would have been more sensible or reasonable to do, or what subsequently reconstructed transaction would yield the most revenue in a particular case.[4] A decision with such predicates should not be permitted to stand.

[3]"As stated in an opinion of the Second Circuit determining the incidence of a tax on income, 'It is elementary that title passes when the parties intend that it shall pass and such intention is to be gathered from the contract and the conduct of the parties * * *' " *Chaplin v. C.I.R.* (C.C.A. 9th, 1943) 136 F.(2d) 298, at 301.

[4]The confusion in this area of law, and the inconsistency of the positions taken by the Government is well illustrated by the decisions discussed in the Tax Court opinion and in the briefs. In addition, attention is invited to two recent decisions.

In *Artis C. Bryan* (1951), 16 T.C. No. 120, taxpayer cited the Tax Court's decision in the instant case for the proposition that certain income in the form of stock was realized in 1943 when restrictions on ownership and disposition were removed. Held: the stock had been "actually received * * * in 1940. Presumably [!] he was entitled to vote it [and receive the dividends on it]."

In *Robert Lehman* (1951), 17 T.C. No. 72, the taxpayer "received" stock in 1943, but his ownership was so restricted that the stock then had no ascertainable market value *and therefore* did not then give rise to income. Against the Commissioner's contention that income was realized on the release of said restrictions, the Tax Court held that the release of restrictions, whereby the

6. This Court cannot permit the fineness of the line between taxability in 1942 as against taxability in 1943 and 1944 to deprive Petitioner of the right to have his case properly classified on the side on which it clearly falls. In a transaction producing ordinary income, Petitioner became the owner of shares then worth $5,000.00, in 1942, and he properly reported the $5,000.00 as ordinary income for 1942. He is factually, legally, and morally entitled to be sustained.

Dated, San Francisco, California,
March 28, 1952.

FREED, GEBAUER & FREED,
Counsel for Petitioner.

ELI FREED,
EMMETT GEBAUER,
SCOTT FLEMING,
Of Counsel.

taxpayer became "the unrestricted owner (cf. the ultimate findings of 'fact' herein) of the shares", was not a taxable event.

If the stock in the instant case was issued and pledged (as was the plain intent of the parties) then the *Hall* decision holds, contrary to the *Lehman* case, that the release of restrictions is a taxable event.

CERTIFICATE OF COUNSEL.

I hereby certify that I am of counsel for petitioner in the above entitled cause and that in my judgment the foregoing petition for a rehearing is well founded in point of law as well as in fact and that said petition for a rehearing is not interposed for delay.

Dated, San Francisco, California,
March 28, 1952.

SCOTT FLEMING,
Of Counsel for Petitioner.

No. 12806

United States Court of Appeals

for the Ninth Circuit.

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

vs.

WESTERN CONSTRUCTION COMPANY, Respondent.

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

vs.

ALBIN JOHNSON, Respondent.

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

vs.

ELLEN M. JOHNSON, Respondent.

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vs.

HULDAH JOHNSON, Respondent.

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

vs.

GEORGE J. JOHNSON, Respondent.

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

vs.

J. A. JOHNSON Respondent.

Transcript of Record

In Two Volumes

Volume I

(Pages 1 to 334)

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Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.

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——recross 600

Wallin, Mrs. Bernice Catherine

——direct 535

——cross 541

——redirect 544

——recross 544

Wallin, Glen

——direct 546

——cross 547

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Witnesses, Respondent's:

Johnson, Albin

——direct 634

——cross 636

Potts, Mrs. Lucille Easterbrook

——direct 637, 647

——cross 649

Von Harten, John H.

——direct 619

——cross 633

APPEARANCES

For Petitioner:

RALPH B. POTTS, ESQ.,

CARBERY O'SHEA, ESQ.

For Respondent:

WILFORD H. PAYNE, ESQ.

The Tax Court of the United States

Docket No. 15495

WESTERN CONSTRUCTION COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DOCKET ENTRIES

1947

Aug. 11—Petition received and filed. Taxpayer notified. Fee paid.

Aug. 12—Copy of petition served on General Counsel.

Sept.29—Amended petition filed by petitioner. 9/30/47 Copy served.

Sept.30—Motion for extension to Nov. 3, 1947, to file answer filed by General Counsel. Granted.

Oct. 20—Answer to petition as amended filed by General Counsel.

Oct. 20—Request for hearing at Seattle, Washington, filed by General Counsel.

Oct. 29—Notice issued placing proceeding on Seattle, Wash., calendar. Service of answer and request made.

Dec. 17—Reply to answer to amended petition lodged by taxpayer. 3/2/48 filed.

1948

Mar. 1—Motion for leave to file reply out of time filed by taxpayer. 3/2/48 Granted and reply filed. 3/2/48 Copy served.

Mar. 23—Hearing set 5/17/48, Seattle, Wash.

May 24, 25 & 26—Hearing had before Judge Black on merits, consolidated & cases kept open to receive claim for refund; respondent to file amendment to answer by 6/20/48; reply 7/10/48. Stipulation of facts filed. Briefs due 8/15/48, replies 9/15/48.

July 12—Transcript of hearing May 24, 1948 filed.

July 12—Transcript of hearing May 25, 1948 filed.

July 12—Transcript of hearing May 26, 1948 filed.

Aug. 9—Motion for extension to 9/1/48 to file brief filed by taxpayer. 8/10/48 Granted.

Aug. 30—Motion for extension to 9/20/48 to file both briefs filed by taxpayer. 8/31/48 Granted.

Aug. 30—Entry of appearance of Carbery O'Shea.

Sept. 8—Brief filed by General Counsel.

Sept. 16—Motion for extension to Oct. 5, 1948, to file brief filed by taxpayer. Granted.

Oct. 5—Brief filed by taxpayer. Copy served.

Nov. 1—Reply brief filed by taxpayer. Copy served.

Nov. 5—Reply brief filed by General Counsel. Served 11/8/48.

1950

Mar. 22—Findings of fact and opinion rendered, Black, J. Decision will be entered under rule 50. 3/23/50 Copy served.

June 1—Respondent's computation filed.

June 6—Hearing set July 13/50 on respondent's computation.

July 13—Hearing had before Judge Kern on settlement, uncontested, referred to J. Black.

July 14—Decision entered, Black, J., Div. 15.

Oct. 9—Petition for review by U. S. Court of Appeals, 9th Circuit, filed by General Counsel.

Oct. 9—Stipulation of venue filed.

Nov. 3—Motion for extension to Jan. 5/51 to prepare and transmit the record filed by General Counsel.

Nov. 6—Proof of service filed.

Nov. 6—Proof of service with attached affidavit filed.

Nov. 3—Order enlarging time to Jan. 5/51 to prepare and transmit the record entered.

Dec. 21—Statement re diminution of record filed by General Counsel.

Dec. 21—Statement of points with statement of service thereon filed by General Counsel.

[Title of Tax Court and Cause.]

Docket No. 15495

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his Notice of Deficiency (Bur. Symbols, Seattle IT:90D:DM), dated May 29th, 1947, and as a basis for his proceeding alleges as follows:

1. That the petitioner is a limited partnership regularly and duly created under the laws of the State of Washington with main offices at 605 Arctic Building, Seattle, 4, Washington. The returns for the periods here involved were filed with the Collector of Internal Revenue for the Tacoma District of the State of Washington.

2. The notice of deficiency (a copy of which is attached hereto and marked Exhibit A) was mailed to the petitioner on May 29th, 1947.

3. The taxes in controversy are income taxes for the calendar years 1942, 1943, 1944 and 1945 and are in the total amount of $594,735.72.

4. The determination of tax set forth in the said notice of deficiency is based on the following errors:

(a) That the Commissioner erred in making a determination that the limited partnership agreements of February 24th, 1942, and June 30th, 1943, of the general partners and limited partners of the Western Construction Company constituted an association, taxable as a corporation as prescribed by

Section 3797 (a) (3) of the Internal Revenue Code and Section 29.3797-5 of Regulations 111, and consequently assessing declared value excess profits tax and excess profits taxes and income and surtax as a corporation.

5. . The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) That J. A. Johnson, George Johnson and Albin Johnson as general partners, and Eleanor Rector, Evelyn Jorgens and Roy W. Johnson, Lloyd W. Johnson, Bernice Wallin, Winston Johnson, and Elsie Keil as limited partners formed on February 24th, 1942, a limited partnership under the laws of the State of Washington, complying in all respects with said laws; that it was the intention of all partners, both general and limited, to form a partnership for the purpose of conducting a general contracting business; that said partnership was in all respects carried on as a partnership, keeping its records and books as a partnership and doing all business as a partnership. That on June 30th, 1943, J. A. Johnson, George Johnson and Albin Johnson as general partners, Eleanor Rector, Evelyn Jorgens, Roy W. Johnson, Lloyd Johnson, Bernice Wallin, Winston Johnson, Elsie Keil, Lorraine Elingson, Rachel Gustafson and Vedola Johnson Kent, as limited partners amended the first Articles of Co-Partnership under the limited partnership laws of the State of Washington by forming a second limited partnership complying in all respects with the limited partnership laws of the State of Washington, maintained its books of accounts as a

partnership and in all respects doing business as a partnership. That in both said partnerships, the general partners assumed their proportionate shares of all profits and losses and in both partnerships the limited partners assumed their full liability under the limited partnership laws of the State of Washington and proportionately were entitled to their share of profits of the said partnership, if any; that said limited partners contributed additional capital and/or services to the said partnership.

That while it was provided in the Articles of Co-partnership that "The term for which the partnership shall exist is for ten years" that this clause merely restricted the duration of the partnership and did not extend the rights of the partnership after the death of a partner. That the laws of the State of Washington at the time of the formation of both of said copartnerships provided for the dissolution of said partnership upon the death of any partner and that the provision in the partnership agreement that the right is given to the general partners to continue the business upon the death or retirement of a general partner or a limited partner was for the purpose of maintaining the business as a going concern for the benefit of the beneficiary of the deceased partner, as well as the other partners during the probate of the deceased partner's estate and the winding up and dissolution of the partnership. That said copartnership kept its bank accounts as a copartnership and not as a corporation or association; that said copartnership kept its respective books and records as a copart-

nership and not as a corporation or association. That said copartnership had no officers or had not made or filed any articles of incorporation or association and that said copartnerships had conducted every aspect of its respective business as a limited copartnership, complying in all respects with the laws of the State of Washington, pertaining to limited partnerships.

6. That the Commissioner of Internal Revenue, the respondent herein did at approximately the same time that he made the re-determination of income tax liability disclosing a deficiency of $594,735.72 herein, determining that the limited partnership agreements set forth above constituted an association taxable as a corporation, gave notice of deficiency to the three general partners herein, distributing the entire income of the copartnership including the income of the limited partners to the three general partners. That the total sum of said notices of deficiency covering the Commissioners distributing the entire taxable income of the limited partnership to the three general partners, and the assessment against the alleged association is more than the entire income of said limited partnership during said taxable years of 1943, 1944 and 1945. That the respondent herein should be required to make an election as to which course respondent wishes to pursue, to wit: to assess the entire taxable income of said limited partnership to the three general partners or to the limited partnership as an association—one or the other—prior to the hearing of this case upon its merits. That the Commissioner

cannot in law or in equity at one and the same time distribute the income of the same entity to both the general partners and to an "association" composed of the general and limited partners.

Wherefore the petitioner prays that this Court may hear the proceeding and determine that the deficiency shown in the total amount of $594,735.72 as due from the petitioner for the years 1942, 1943, 1944 and 1945 should be voided and eliminated and that the petitioner be found not to be indebted to the United States Government for income taxes for said years.

/s/ RALPH B. POTTS,
Attorney for Petitioner.

State of Washington,
County of King—ss.

J. A. Johnson, being duly sworn, says that he is one of the general partners of the petitioner above named; that he has read the foregoing petition, or has had the same read to him, and is familiar with the statements contained therein, and that the statements contained therein are true, except those stated to be upon information and belief, and that those he believes to be true.

/s/ J. A. JOHNSON.

Subscribed and sworn to before me this 30th day of July, 1947.

[Seal] /s/ LUCILLE POTTS,
Notary Public in and for the State of Washington,
Residing at Seattle.

EXHIBIT A

Treasury Department
Internal Revenue Service
Seattle 1, Washington

May 29, 1947

Office of
Internal Revenue Agent in Charge
Seattle Division
305 A 1331 Third Avenue Building

IT:90D:DM

Western Construction Company
605 Arctic Building
Seattle, Washington

Gentlemen:

You are advised that the determination of your income tax liability for the taxable years ended December 31, 1942, December 31, 1943, December 31, 1944, and December 31, 1945, discloses a deficiency of $16,342.99; and the determination of your declared value excess profits tax liability for the taxable years mentioned discloses a deficiency of $117,753.45; and the determination of your excess profits tax liability for such years discloses a deficiency of $594,735.72, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Saturday, Sunday

or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the Tax Court of the United States, at its principal address, Washington 25, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Seattle 1, Washington, for the attention of IT:90D:DM. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

JOSEPH D. NUNAN, JR.,
Commissioner.

By /s/ L. E. HALLOWELL,
Acting Internal Revenue
Agent in Charge.

DM:mts

Enclosures:
Statement
Form of waiver

STATEMENT

:90D:DM

Western Construction Company
605 Arctic Building
Seattle, Washington

Tax liability for the taxable years ended December 31, 1942, De-
ıber 31, 1943, December 31, 1944, and December 31, 1945.

ar	Liability	Assessed	Deficiency
	Income Tax		
2	$ 4,085.00	none	$ 4,085.00
3	4,703.95	none	4,703.95
4	3,152.71	none	3,152.71
5	4,401.33	none	4,401.33
	$ 16,342.99		$ 16,342.99
	Declared Value Excess-Profits Tax		
2	$ 49,390.07	none	$ 49,390.07
3	43,432.61	none	43,432.61
4	6,677.60	none	6,677.60
5	18,253.17	none	18,253.17
	$117,753.45		$117,753.45
	Excess Profits Tax		
2	$255,736.68	none	$255,736.68
3	223,777.92	none	223,777.92
4	27,574.04	none	27,574.04
5	87,647.08	none	87,647.08
	$594,735.72		$594,735.72

In making this determination of your income, declared value ex-
profits and excess profits tax liability, careful consideration has
n given to the report of examination dated October 21, 1946; to
r protest dated January 14, 1947; and to the statements made at
conference held on April 14, 1947.

A copy of this letter and statement has been mailed to your repre-
ative, Mr. John H. Von Harten, 1411 Fourth Avenue Building,
ttle 1, Washington.

It is held that for income tax, declared value excess profits tax
excess profits tax purposes the Western Construction Company
er the so-called limited partnership agreements of February 24,
2, and June 30, 1943, constitutes an association taxable as a cor-
ation as prescribed by Section 3797 (a) (3) of the Internal Reve-
Code and Section 29.3797-5 of Regulations 111.

An excess profits credit based on invested capital has been com-
ed for each year on the capital and personal account balances at

the beginning of each year, less accrued corporation income taxe Appropriate recognition has been given to new capital under Sectio 718 (a) (6) of the Internal Revenue Code subject to the limitatior of Section 718 (a) (6) (E).

Taxable Year Ended December 31, 1942

Adjustments to Net Income

Since no corporation return was filed, taxable net income has bee computed as follows:

Net income per Western Construction Co. books		$421,359.1
Less salaries allowed:		
Winston Johnson	$ 1,513.04	
John A. Johnson	15,000.00	
George J. Johnson	15,000.00	
Albin Johnson	15,000.00	46,513.0
Charitable donations		678.9
Net income for declared value excess profits tax		$374,167.1

Declared Value Excess Profits Tax Computation

Net income for declared value excess-profits tax computation				$374,167.1
Less 10% of none.... value of capital stock as declared for the year ended June 30, 1942				none
Net income subject to declared value excess-profits tax				$374,167.
Portion	Amount	Rate	Tax	
5% of declared value of capital stock			none	
Balance	$374,167.17	13.2%	$49,390.07	
Total declared value excess profits tax				49,390.
Declared value excess-profits tax previously assessed				no retur
Deficiency of declared value excess-profits tax				$ 49,390.

Income Tax Computation—Normal Tax Net Income Computation

Net income for declared value excess-profits tax computation	$374,167.
Less: Declared value excess-profits tax	49,390
Net income	$324,777
Adjusted net income	$324,777
Less: Income subject to excess profits tax	309,277
Normal tax net income and surtax net income	$ 15,500

Normal Tax Computation

ɔrmal-tax net income			$ 15,500.00
	Portion	Rate	Amount of Tax
ɔrtion of normal-tax net income (not in excess of $5,000); and tax	$5,000.00	15%	$ 750.00
ɔrtion of normal-tax net income (in excess of $5,000 and not in excess of $20,000); and tax	10,500.00	17%	1,785.00
ɔtal normal tax			$2,535.00

Surtax Computation

ɪrtax net income	$15,500.00

Corporations With Surtax Net Incomes Over $50,000

	Portion	Rate	Amount of Tax
ɛrtion of surtax net income (not in excess of $25,000); and tax	$15,500.00	10%	$1,550.00
tal normal tax and surtax			$4,085.00
ɔome tax assessed			no return
ficiency of income tax			$4,085.00

Excess Profits Tax Computation

cess profits net income (adjusted net income supra)		$324,777.10
ss: Specific exemption	$ 5,000.00	
Excess profits credit	10,500.00	15,500.00
justed excess profits net income		$309,277.10
per cent of $309,277.10		278,349.39
ɛtax net income (computed without regard to the credit provided by section 26 (e)		324,777.10
per cent of $324,777.10		259,821.68
ome tax		4,085.00
ɛess of $259,821.68 over $4,085.00		$255,736.68
8,349.39 or $255,736.68 whichever is lesser		$255,736.68
rect excess profits tax liability		255,736.68
vious assessment		none
iciency in excess profits tax		$255,736.68

Taxable Year Ended December 31, 1943

Adjustments to Net Income

Since no corporation return was filed, taxable net income has bee
computed as follows:

Net income per Western Construction Co. books		$383,828.1
Less salaries:		
Albin Johnson	$15,000.00	
John A. Johnson	15,000.00	
George Johnson	15,000.00	
Roy Johnson	5,375.71	
Winston Johnson	3,792.44	54,168.1
Charitable donations		625.0
Net income for declared value excess profits tax		$329,034.9

Declared Value Excess-Profits Tax Computation

Net income for declared value excess-profits tax computation		$329,034.9
Less: 10% of none.... value of capital stock as declared for the year ended June 30, 1943		none
Net income subject to declared value excess profits tax		$329,034.9

Portion	Amount	Rate	Tax	
5% of declared value of capital stock				
Balance	$329,034.95	13.2%	$43,432.61	
Total declared value excess profits tax				43,432.
Declared value excess profits tax previously assessed				no retu
Deficiency of declared value excess-profits tax				$ 43,432.

Income Tax Computation—Normal Tax Net Income and Surtax Net Income Computation

Net income for declared value excess profits tax computation	$329,034.
Less: Declared value excess profits tax	43,432
Net income	$285,602
Adjusted net income	285,602
Less: Income subject to excess profits tax	267,809
Normal-tax net income and surtax net income	$ 17,792

Normal Tax Computation

ormal-tax net income			$ 17,792.39
	Portion	Rate	Amount of Tax
ɔrtion of normal-tax net income (not in excess of $5,000); and tax	$5,000.00	15%	$ 750.00
ɔrtion of normal-tax net income (in excess of $5,000 and not in excess of $20,000); and tax	12,792.39	17%	2,174.71
ɔtal normal tax			$2,924.71

Surtax Computation

ırtax net income	$17,792.39

Corporations With Surtax Net Incomes Not Over $50,000

	Portion	Rate	Amount of Tax
ɔrtion of surtax net income (not in excess of $25,000); and tax	$17,792.39	10%	$1,779.24
ɔtal normal tax and surtax			$4,703.95
come tax assessed			no return
ɛficiency of income tax			$4,703.95

Excess Profits Tax Computation—1943

ɛcess profits net income (adjusted net income supra)		$285,602.34
ss: Specific exemption	$ 5,000.00	
Excess profits credit	12,792.39	17,792.39
djusted excess profits net income		$267,809.95
per cent of $267,809.95		241,028.96
rtax net income (computed without regard to the credit provided by section 26 (c))		285,602.34
per cent of $285,602.34		228,481.87
ɔme tax (other than section 102)		4,703.95
cess of $228,481.87 over $4,703.95		223,777.92
41,028.96 or $223,777.92, whichever is lesser		223,777.92
rrect excess profits tax liability		223,777.92
ficiency in excess profits tax		none
		223,777.92

Taxable Year Ended December 31, 1944

Adjustments to Net Income

Since no corporation return was filed, taxable net income has been computed as follows:

Net income per Western Construction Co. books		$102,854.22
Less salaries:		
J. A. Johnson	$15,000.00	
George Johnson	15,000.00	
Albin Johnson	15,000.00	
Roy Johnson	2,099.72	
Winston Johnson	4,033.51	51,133.23
Charitable donations		715.00
Long-term capital gain		418.09
Net income for declared value excess profits tax purposes		$ 50,587.90

Declared Value Excess-Profits Tax Computation

Net income for declared value excess-profits tax computation	$ 50,587.90
Less: 10% of none.... value of capital stock as declared for the year ended June 30th, 1944	none
Net income subject to declared value excess-profits tax	50,587.90

	Amount	Rate	Tax
Balance	$50,587.90	13.2%	$6,677.60
Total declared value excess-profits tax			6,677.60
Declared value excess profits tax assessed			no return
Deficiency of declared value excess-profits tax			$ 6,677.60

Normal-Tax Net Income and Surtax Net Income Computation

Net income for declared value excess profits tax computation	$ 50,587.9
Excess of net long-term capital gain over net short-term capital loss	418.0
Total	$ 51,005.9
Less: Declared value excess profits tax	6,677.6
Net income	44,328.2
Adjusted net income	44,328.2
Less: Adjusted excess profits net income	32,250.3
Normal tax net income and surtax net income	$ 12,078.0

Computation of Income Tax—1944

Your income tax liability is properly computed under the alternative tax method as follows:

ormal tax and surtax net income including long term capital gain		$ 12,078.05
ess: Long-term capital gain		418.09
alance of normal tax and surtax net income		$ 11,659.96
ormal tax: $5,000.00 at 15%	$ 750.00	
$6,659.96 at 17%	1,132.19	$1,882.19
urtax ($11,659.96) at 10%	1,166.00	
artial tax		3,048.19
dd: 25% of long-term capital gain $418.09		104.52
otal alternative tax		$ 3,152.71
ncome tax liability		3,152.71
ncome tax assessed		none
eficiency of income tax		$ 3,152.71

Computation of Excess Profits Tax—1944

xcess Profits Credit		
Capital and surplus beginning of year:		
Capital and personal accounts	$597,725.88	
Less: 1942 and 1943 taxes accrued	581,126.23	16,599.65
New capital as limited bySec. 718 (a) (6) (E)	$16,599.65	
25% of new capital		4,149.91
Invested capital		$ 20,749.56
Credit—8% of $20,749.56		$ 1,659.96
xcess Profits Tax		
Adjusted net income	$ 44,328.39	
Less: Long-term capital gain	418.09	
Excess profits net income		$ 43,910.30
Less: Specific exemption	10,000.00	
Excess profits credit	1,659.96	11,659.96
Adjusted excess profits net income		32,250.34
95% of $32,250.34		30,637.82
Tentative excess profits tax		30,637.82
Less: Credit under Sec. 784 (10% of $30,637.82)		3,063.78
Correct excess profits tax liability		27,574.04
Previous assessment		none
Deficiency in excess profits tax		$ 27,574.04

Taxable Year Ended December 31, 1945

Adjustments to Net Income

Since no corporation return was filed, taxable net income has bee
computed as follows:

Net income per Western Construction Co. books		$195,869.5
Less salaries		
J. A. Johnson	$15,000.00	
George Johnson	15,000.00	
Albin Johnson	15,000.00	
Winston Johnson	4,178.48	49,178.4
Charitable contributions		1,204.1
Long-term capital gain		7,205.3
Net income for declared value excess profits tax purposes		$138,281.5

Declared Value Excess-Profits Tax Computation

Net income for declared value excess profits tax computation	$138,281.5
Less: 10% of none.... value of capital stock as declared for the year ended June 30th, 1945	none
Net income subject to declared value excess-profits tax	$138,281.5

Portion	Amount	Rate	Tax
5% of declared value of capital stock			none
Balance	$138,281.58	13.2%	$18,253.17

Total declared value excess-profits tax	$ 18,253.1
Declared value excess-profits tax assessed	no retur
Deficiency of declared value excess profits tax	$ 18,253.1

Normal Tax Net Income and Surtax Net Income Computation

Net income for declared value excess-profits tax computation	$138,281.5
Add: Excess of net long-term capital gain over net short-term capital loss	7,205.3
Total	$145,486.8
Less: Declared value excess-profits tax	18,253.1
Net income	$127,233.7
Adjusted net income	127,233.7
Less: Adjusted excess profits net income	110,028.4
Normal tax net income and surtax net income	$ 17,205.3

Computation of Income Tax—1945

Your income tax liability is properly computed under the alternative tax method as follows:

ormal tax and surtax net income including long-term capital gain		$ 17,205.31
ss: Long-term capital gain		7,205.31
lance		$ 10,000.00
ormal tax: $5,000.00 at 15%	$750.00	
$5,000.00 at 17%	850.00	$1,600.00
rtax at 10%	1,000.00	
rtial tax		$2,600.00
ld: 25% of long-term capital gain	1,801.33	
tal alternative tax		$4,401.33
come tax liability		4,401.33
come tax assessed		none
ficiency of income tax		$ 4,401.33

Computation of Excess Profits Tax—1945

cess Profits Credit

Capital and surplus beginning of year:		
Capital and personal accounts 12-31-44	$560,871.66	
Less: Accrued income taxes		
1942	$309,211.75	
1943	271,914.48	
1944	37,404.35	618,530.58
Balance		$(57,658.92)
Invested capital		none
Excess profits credit		none

Excess profits tax		
Adjusted net income	$127,233.72	
Less: Long-term capital gain	7,205.31	
Excess profits net income		$120,028.41
Less: Specific exemption	10,000.00	
Excess profits credit	none	10,000.00
Adjusted excess profits net income		110,028.41
95% of $110,028.41		104,526.99
Surtax net income (without regard to Section 26 (e) credit)		127,233.72
80% of $127,233.72		101,786.98
Income tax		4,401.33
Excess of $101,786.98 over $4,401.33		97,385.65
$104,526.99 or $97,385.65, whichever is lesser		97,385.65
Less: Credit under Section 784 (10% of $97,385.65)		9,738.57
Correct excess profits tax liability		87,647.08
Previous assessment		none
Deficiency in excess profits tax		$ 87,647.08

Received and Filed T.C.U.S. August 11, 1947.

[Title of Tax Court and Cause.]

AMENDED PETITION

Comes now the above-named petitioner and moves the Court that the petitioner's petition be amended as follows:

I.

That Paragraph three of the petition be amended to read:

"The taxes in controversy in this proceeding are:

Year	Kind of Tax	Alleged Deficiency
1942	Income Tax	$ 4,085.00
1943	Income Tax	4,703.95
1944	Income Tax	3,152.71
1945	Income Tax	4,401.33
		$ 16,342.99
1942	Declared Value Excess Profits Tax	$ 49,390.07
1943	Declared Value Excess Profits Tax	43,432.61
1944	Declared Value Excess Profits Tax	6,677.60
1945	Declared Value Excess Profits Tax	18,253.17
		$117,753.45
1942	Excess Profits Tax	$255,736.68
1943	Excess Profits Tax	223,777.92
1944	Excess Profits Tax	27,574.04
1945	Excess Profits Tax	87,647.08
		$594,735.72
	Aggregate Total	$728,832.16."

That the above be substituted for said paragraph three of the original petition.

II.

That Paragraph Six of the petition be amended to substitute the sum of $728,832.16 for the sum of $594,735.72.

III.

That the petitioner's prayer for relief in the original petition be amended as follows:

"Wherefore the petitioner prays that this Court may hear the proceeding and determine that the deficiencies shown in the total amount of $728,832.16 as due from the petitioner for the years 1942, 1943,

1944 and 1945 should be voided and eliminated and that the petitioner be found not to be indebted to the United States Government for any of said income tax for said years."

That the foregoing prayer be substituted for said prayer as set out in the original petition.

This motion is based upon the file herein and upon the following affidavit:

State of Washington,
County of King—ss.

Ralph B. Potts, being first duly sworn on oath deposes and says: That I am counsel for the petitioner above named; that in preparing the petition herein the affiant inadvertently and through error took the sum of $594,735.72, as set forth in Exhibit "A," and particularly the first page of the statement of Exhibit "A," as being the total sum of all of the deficiency assessments rather than just the deficiency covering the Commissioner's determination of excess profits liability; that at the same time the affiant prepared the petition herein, the affiant prepared petitions in the following cases: Albin Johnson vs. Commissioner of Internal Revenue, Docket No. 15496; Ellen M. Johnson vs. Commissioner of Internal Revenue, Docket No. 15497; Huldah Johnson vs. Commissioner of Internal Revenue, Docket No. 15498; George J. Johnson vs. Commissioner of Internal Revenue, Docket No. 15499; J. A. Johnson vs. Commissioner of Internal Revenue, Docket No. 15500; Roberta M. Johnson vs. Commissioner of Internal Revenue, Docket No. 15586; and Lloyd W.

Johnson vs. Commissioner of Internal Revenue, Docket No. 15588; and that in each of the foregoing docket cases the total tax deficiency determined by the Commissioner was the total sum set forth in the same location on Exhibit "A" as the $594,735.72 was set forth in the particular ninety day letter, or Exhibit "A" herein and was in the same arrangement on the page.

That the affiant, however, in paragraph four of the original petition, alleges that "the Commissioner erred in making a redetermination * * * and consequently assessing declared value excess profits tax and excess profits taxes and income and surtax as a corporation." In other words, affiant properly set forth the legal issue but inadvertently and in error neglected to include in the original petition as set forth on Exhibit A the sum of $16,342.99 and the sum of $117,753.45 as income tax liability and declared value excess profits tax liability respectively.

Further affiant saith not.

/s/ RALPH B. POTTS.

Subscribed and sworn to before me this 24th day of September, 1947.

[Seal]: /s/ H. ORLEY SOLOMON,
Notary Public in and for the State of Washington,
Residing at Seattle.

Presented by:

/s/ RALPH B. POTTS,
Attorney for Petitioner.

Received and filed T.C.U.S. September 29, 1947.

[Title of Tax Court and Cause.]

Docket No. 15495

ANSWER TO PETITION AS AMENDED

Now comes the Commissioner of Internal Revenue by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition herein, as amended, admits, alleges, and denies as follows:

1. Admits that Western Construction Company, the petitioner herein, has its main offices at 605 Arctic Building, Seattle 4, Washington. Admits that the said Western Construction Company purports to be a limited partnership under the laws of the State of Washington. It is also admitted that the returns of the Western Construction Company for the taxable years 1942 to 1945 inclusive, (which were made on partnership forms) were filed with the Collector of Internal Revenue for the District of Washington, located at Tacoma, Washington. Denies the remaining allegations contained in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits that the Commissioner has asserted deficiencies in income taxes, declared-value excess profits taxes and excess profits taxes against petitioner for the years and in the amounts set forth in paragraph 3 of the petition as amended, all of which said amounts are in controversy in this proceeding.

4(a). Denies that in determining the deficiencies

asserted in the statutory notice the Commissioner committed errors as alleged in subparagraph (a) of paragraph 4 of the petition. Alleges that in determining the deficiencies asserted for the year 1945, as set forth in the deficiency notice, respondent erred in failing to disallow as costs or expenses to Western Construction Company the sum of $500.00 waived by said company on account of salary payments made during that year in contravention of the Stabilization Act of 1942.

5(a). Admits that under date of February 24, 1942, J. A. Johnson, George Johnson, and Albin Johnson, who are named as general partners, and Eleanor Rector, Evelyn Jorgens, Roy W. Johnson, Lloyd W. Johnson, Bernice Wallin, Winston Johnson, and Elsie Keil, who are named as limited partners, executed a document entitled "Certificate of Formation of a Limited Partnership." It is admitted that under date of June 30, 1943, J. A. Johnson, George Johnson, and Albin Johnson, who are named as general partners, and Eleanor Rector, Evelyn Jorgens, Roy W. Johnson, Lloyd Johnson, Bernice Wallin, Winston Johnson, Elsie Keil, Lorraine Ellingson, Rachel Gustafson, and Vedola Johnson Kent, who are named as limited partners, executed a document entitled "Certificate of Formation of a Limited Partnership." Admits that each of the aforesaid documents provides that "The term for which the partnership shall exist is for ten years." Denies each and every other material allegation contained in subparagraph (a) of paragraph 5 of the petition.

6. Admits that at approximately the same time that respondent issued his notice of deficiency against this petitioner, on the basis that Western Construction Company constituted an association taxable as a corporation for the taxable years 1942 to 1945, inclusive, he also issued notices of deficiency to J. A. Johnson, and his wife, to George Johnson and his wife, and to Albin Johnson in which respondent determined that the alleged limited partners named in the so-called partnership agreements mentioned above were not bona fide partners in the business of the Western Construction Company who might properly be recognized, for Federal tax purposes, and that the entire business income for the taxable years 1942 to 1945, inclusive, was distributable equally to the three alleged general partners of that business, namely: J. A. Johnson, George Johnson, and Albin Johnson. Denies each and every other material allegation contained in paragraph 6 of the petition.

7. Denies generally and specifically each and every material allegation contained in the petition, not hereinbefore specifically admitted, qualified or denied.

8. For further answer to the petition herein respondent affirmatively alleges and shows that the deficiencies in declared-value excess profits taxes and excess profits taxes asserted for the taxable year 1945, as set forth in the deficiency notice from which the petition is taken, are understated on account of the failure of respondent to disallow as

costs to Western Construction Company for that year the sum of $500.00 on account of payments of salaries and wages in contravention of the Stabilization Act of 1942.

9. As a result of certain "Findings and Determination" of the National Wage Stabilization Board, Region XII, in the matter of "George Johnson, J. A. Johnson, and Albin Johnson, individually and as Co-Partners, doing business as Western Construction Company, 605 Arctic Building, Seattle, Washington," Docket No. 60-12-2316, dated April 17, 1946, to the effect that wages and salary payments had been made for the year ended December 31, 1945, in contravention of the Stabilization Act of 1942 and without obtaining approval of the War Labor Board, said Company, as employer, consented and agreed that for the purposes of calculating deductions under the Internal Revenue laws of the United States the sum of $500.00 should be disregarded as costs for said year.

10. The foregoing sum of $500.00 was not taken into account or disallowed as a deduction by respondent in computing the deficiencies in taxes of the Western Construction Company for the taxable year 1945, as determined and set forth in the statutory notice herein.

11. There is, accordingly, due and owing by petitioner for the taxable year 1945, a deficiency in declared-value excess profits tax in the amount of $18,319.17 instead of $18,253.17 as determined in the deficiency notice, and a deficiency in excess profits

tax for said year in the amount of $87,959.56 instead of $87,647.08 as determined in the deficiency notice. The details of the resulting increases in deficiencies as stated above are set forth in the attached recomputation for the year 1945 which is incorporated herein and made a part of this answer.

Wherefore, it is prayed that the petitioner's appeal be denied and that, excepting for the qualifications hereafter set forth, the deficiencies asserted in the statutory notice be sustained. Respondent further prays that this Court redetermine the deficiency in declared-value excess profits tax for the year 1945 to be in the amount determined by the Commisisoner, viz: $18,253.17 plus increased deficiency in the amount of $66.00; and that the Court further redetermine the deficiency in excess profits tax for the year 1945 to be in the amount determined by the Commissioner, viz: $87,647.08 plus an increased deficiency in the amount of $312.48. Claim for the increased deficiencies as stated above is hereby made by respondent pursuant to the provisions of section 272(e) of the Internal Revenue Code.

/s/ CHARLES OLIPHANT WHP
Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel.

WILFORD H. PAYNE,
Special Attorney,
Bureau of Internal Revenue.

Western Construction Company
605 Arctic Building,
Seattle, Washington

Taxable Year Ended December 31, 1945.

Declared-Value Excess Profits Tax

Net income disclosed by the statutory notice of deficiency dated 5/29/47	$138,281.58
Plus: Amount held to be unallowable as a deduction on account of salaries found by the National Wage Stabilization Board to have been paid in contravention of the Stabilization Act of 1942	500.00
Net income revised	$138,781.58
Less: 10% of $0.00—declared-value of capital stock for year ended 6/30/45	None
Balance subject to declared-value excess profits tax	$138,781.58
Declared-value excess profits tax at 13.2% on $138,781.58	18,319.17
Previously assessed—no return filed	None
Deficiency in declared-value excess profits tax	$ 18,319.17
Deficiency disclosed by the statutory notice of deficiency	18,253.17
Difference due to increase in income	$ 66.00

Income Tax

Net income for declared-value excess profits tax purposes	$138,781.58
Plus: Net long term capital gain	7,205.31
Net income	$145,986.89
Less: Declared-value excess profits tax	18,319.17
Adjusted net income	127,667.72
Less: Adjusted excess profits net income	110,462.41
Normal tax net income	17,205.31

Alternative Tax

Normal tax net income	$ 17,205.31
Less: Net long term capital gain	7,205.31
Balance	$ 10,000.00
Normal tax at 15% on $5,000.00	750.00
Normal tax at 17% on $5,000.00	850.00

Total normal tax	$ 1,600.00
Surtax at 10% on $10,000	1,000.00
Partial tax	2,600.00
Plus: 25% of long-term capital gain	1,801.33
Income tax liability	$ 4,401.33
Previously assessed—no return filed	None
Deficiency in income tax	$ 4,401.33
Deficiency disclosed by statutory notice of deficiency	4,401.33
Difference	None

Excess Profits Tax

Net income disclosed by the statutory notice of deficiency dated 5/29/47		$120,028.41
Plus: Amount held to be unallowable as a deduction on account of salaries found by the National Wage Stabilization Board to have been paid in contravention of the Stabilization Act of 1942		500.00
Balance		120,528.41
Less: Additional declared-value excess profits tax		66.00
Net income revised		$120,462.41
Less: Specific exemption	$10,000	
Excess profits credit	None	10,000.00
Adjusted excess profits net income		$110,462.41
95% of $110,462.41		$104,939.29
80% of $127,667.72		102,134.18
Less: Income tax under Chapter I		4,401.33
Excess profits tax		$ 97,732.85
Less: 10% of $97,732.85—current credit		9,773.29
Excess profits tax liability		$ 87,959.56
Previously assessed—no return filed		None
Deficiency in excess profits tax		$ 87,959.56
Deficiency disclosed by the statutory notice of deficiency		87,647.08
Difference due to increase in income		$ 312.48

Received and Filed T.C.U.S. October 20, 1947.

[Title of Tax Court and Cause.]

Docket No. 15495

REPLY TO ANSWER TO PETITION AS AMENDED

Comes now the petitioner by its attorney, Ralph B. Potts, and for reply to the Answer to Petition as Amended admits, alleges and denies as follows:

I.

In reply to the affirmative matter set up in Paragraphs 8, 9, 10 and 11 of said Answer, petitioner admits that the respondent herein disallowed as costs to petitioner for the taxable year 1945, the sum of $500.00 on account of payment of salary and wages in contravention of the Stabilization Act of 1942 and that on or about September 17th, 1946, the National Wage Stabilization Board, Region XII, in the matter of, "George Johnson, J. A. Johnson and Albin Johnson, individually and as sole partners doing business as Western Construction Compay, 605" made certain findings and determination to the effect that wages and salary payments had been made for the year ended December 31st, 1945, in contravention of the Stabilization Act of 1942 and without obtaining approval of the War Labor Board, and that therefore for the purposes of calculating deductions under the Internal Revenue Laws of the United States, the sum of $500.00 should be disregarded as costs for said year. That said sum of $500.00 was not taken into account or disallowed as a deductible cost in computing the deficiencies in taxes of the petitioner herein for the

taxable year 1945, as determined and set forth in the statutory notices herein, and petitioner admits that there is accordingly due and owing by petitioner for the taxable year, a difference in declared-value excess profits tax in the sum of $66.00 and a difference in excess profits for said year in the amount of $312.48 as determined in the deficiency notice.

II.

Petitioner denies each and every allegation and thing affirmatively pleaded in said Answer to Petition as Amended.

Wherefore your petitioner prays for judgment as prayed for in its Petition as Amended with the exception of the corrected matter set forth immediately above.

/s/ RALPH B. POTTS,
Counsel for Petitioner.

State of Washington,
County of King—ss.

J. A. Johnson, being duly sworn, says that he is one of the general partners of the petitioner above named; that he has read the foregoing Reply or has had the same read to him, and is familiar with the statements contained therein, and that the statements contained therein are true, except those stated to be upon information and belief, and that those he believes to be true.

/s/ J. A. JOHNSON.

Subscribed and sworn to before me this 12th day of December, 1947.

[Seal] /s/ RALPH B. POTTS,
Notary Public in and for the State of Washington,
Residing at Seattle.

Received T.C.U.S. December 16, 1947.

Lodged T.C.U.S. December 17, 1947.

Filed T.C.U.S. March 2, 1948.

The Tax Court of the United States
Washington

Docket No. 15495

WESTERN CONSTRUCTION COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Court as set forth in its Findings of Fact and Opinion promulgated March 22, 1950, the respondent herein filed a computation on June 1, 1950, which was not contested by petitioner when called for hearing July 13, 1950, now therefore, it is

Ordered and Decided: That there are no defi-

ciencies in income tax, declared value excess-profits tax and excess profits tax for the calendar years 1942, 1943, 1944 and 1945.

[Seal] /s/ EUGENE BLACK,
Judge.

Entered July 14, 1950.

Served July 14, 1950.

[Title of Tax Court and Cause.]

Docket No. 15495

STIPULATION OF VENUE

Pursuant to the provisions of Section 1141(b)(2) of the United States Internal Revenue Code, it is hereby agreed and stipulated that the decision of The Tax Court of the United States in this proceeding may be reviewed by the United States Court of Appeals for the Ninth Circuit.

/s/ CHARLES OLIPHANT, C.A.R.
Chief Counsel, Bureau of Internal Revenue, Attorney for Respondent.

/s/ RALPH B. POTTS,
Attorney for Petitioner.

Received and filed T.C.U.S. October 9, 1950.

In the United States Court of Appeals
for the Ninth Circuit

T. C. Docket No. 15495

COMMISSIONER OF INTERNAL REVENUE,
Petitioner on Review,

vs.

WESTERN CONSTRUCTION COMPANY,
Respondent on Review.

PETITION FOR REVIEW

To the Honorable Judges of the United States Court of Appeals for the Ninth Circuit:

The Commissioner of Internal Revenue hereby petitions the United States Court of Appeals for the Ninth Circuit to review the decision entered by The Tax Court of the United States on July 14, 1950, "that there are no deficiencies in income tax, declared value excess profits tax and excess profits tax for the calendar years 1942, 1943, 1944 and 1945" in respect of the above-named respondent on review. This petition for review is filed pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code. The parties have stipulated, pursuant to the provisions of Section 1141(b)(2) of the Internal Revenue Code, that the decision of The Tax Court of the United States in this proceeding may be reviewed by the United States Court of Appeals for the Ninth Circuit.

The respondent on review, Western Construction Company, is a limited partnership created under the laws of the State of Washington having its office at 605 Arctic Building, Seattle 4, Washington. Its

partnership returns for the years 1942 to 1945, inclusive, the years here involved, were filed with the Collector of Internal Revenue for the District of Washington, whose office is located in Tacoma, Washington.

Nature of Controversy

The respondent on review, Western Construction Company, was created as a limited partnership under the laws of the State of Washington in 1942 and again in 1943. Its certificate of formation included J. A. Johnson, George Johnson and Albin Johnson, three brothers, as its general partners and their several adult sons and daughters as limited partners. The partnership was engaged during the taxable years involved in the general contracting business. Prior to its organization the business had been conducted by a predecessor corporation known as Western Construction Company, Inc. In his determination of the deficiencies in income, declared value excess profits, and excess profits taxes which gave rise to the present proceeding, the Commissioner determined that the respondent, Western Construction Company, under the so-called limited partnership agreements of February 24, 1942, and June 30, 1943, constituted an association taxable as a corporation as prescribed by Section 3797(a)(3) of the Internal Revenue Code and Section 29.3797-5 of Regulations 111. The Tax Court of the United States disagreed with the Commissioner's determination and held that the Western Construction Company was a bona fide partnership composed of the three Johnson brothers and their several children as set out in the certificate of formation of the partnership and that

it should be so recognized for tax purposes. Accordingly, in conformity of its opinion, the Tax Court entered its decision that there are no deficiencies in income tax, declared value excess profits tax and excess profits tax for the calendar years 1942, 1943, 1944 and 1945.

/s/ THERON L. CAUDLE, C.A.R.
Assistant Attorney General.

/s/ CHARLES OLIPHANT, C.A.R.
Chief Counsel, Bureau of Internal Revenue, Attorneys for Petitioner on Review.

Received and filed T.C.U.S. October 9, 1950.

[Title of Court of Appeals and Cause.]

T. C. Docket No. 15495

STATEMENT OF POINTS

Comes Now the Commissioner of Internal Revenue, petitioner on review in the above-entitled cause, by and through his attorneys, Theron L. Caudle, Assistant Attorney General, and Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, and hereby states that he intends to rely upon the following points in this proceeding:

The Tax Court of the United States erred:

1. In entering its decision that there are no deficiencies in income tax, declared value excess profits tax and excess profits tax for the calendar years 1942, 1943, 1944 and 1945.

2. In failing and refusing to sustain the deficiencies in tax determined by the Commissioner in so far as such deficiencies resulted from his determination that respondent on review was, during the taxable years involved, an association taxable as a corporation.

3. In holding and deciding that the respondent on review does not resemble an association in corporate form and is, therefore, not taxable as a corporation.

4. In failing and refusing to hold and decide, as determined by the Commissioner, that the respondent on review, under the so-called limited partnership agreements of February 24, 1942, and June 30, 1943, constituted an association taxable as a corporation as prescribed by Section 3797(a)(3) of the Internal Revenue Code and the Commissioner's regulations.

5. In that its ultimate finding that the taxpayer was not an association taxable as a corporation and its opinion and its decision are not supported by but are contrary to the evidence.

6. In that its opinion and its decision are contrary to law and the Commisisoner's regulations.

/s/ THERON L. CAUDLE, C.A.R.
Assistant Attorney General.

/s/ CHARLES OLIPHANT, C.A.R.
Chief Counsel, Bureau of Internal Revenue, Attorneys for Petitioner on Review.

Statement of Service attached.

Received and filed T.C.U.S. December 21, 1950.

The Tax Court of the United States

Docket No. 15496

ALBIN JOHNSON,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

1947

Aug. 11—Petition received and filed. Taxpayer notified. Fee paid.

Aug. 12—Copy of petition served on General Counsel.

Oct. 1—Answer filed by General Counsel.

Oct. 1—Request for hearing in Seattle filed by General Counsel.

Oct. 10—Notice issued placing proceeding on Seattle, Wash., calendar. Service of answer and request made.

1948

Mar. 23—Hearing set 5/17/48, Seattle, Wash.

May 24, 25 & 26—Hearing had before Judge Black on merits. Oral motion to consolidate Docket 15496, 15497, 15498, 15499, 15500 & 15586 & 15588. Oral motion to keep cases open to receive claim for refund.

1948

Respondent to file amendment to answer by 6/20/48; petitioner's reply due 7/10/48; stipulation of facts filed. Briefs due 8/15/48; replies 9/15/48.

June 15—Amendment to respondent's answer filed by General Counsel.

July 12—Transcript of hearing May 24, 1948, filed.

July 12—Transcript of hearing May 25, 1948, filed.

July 12—Transcript of hearing May 26, 1948, filed.

Aug. 9—Motion for extension to 9/1/48 to file brief filed by taxpayer. 8/10/48 Granted.

Aug. 30—Motion for extension to 9/20/48 to file both briefs filed by taxpayer. 8/31/48 Granted.

Aug. 30—Entry of appearance of Carbery O'Shea as counsel filed.

Sept. 8—Brief filed by General Counsel.

Sept. 16—Motion for extension to Oct. 5, 1948, to file brief by taxpayer. Granted.

Oct. 5—Brief filed by taxpayer. Copy served.

Nov. 1—Reply brief filed by taxpayer. Copy served.

Nov. 5—Reply brief filed by General Counsel.

1950

Mar. 22—Findings of fact and opinion rendered, Black, J. Decision will be entered under rule 50. Copy served 3/23/50.

June 1—Respondent's computation filed.

June 6—Hearing set July 13/50 on respondent's computation.

July 13—Hearing had before Judge Kern on settlement, uncontested, referred to J. Black.

July 14—Decision entered, Black J., Div. 15.

Oct. 9—Petition for review by U. S. Court of Appeals, 9th Circuit, filed by General Counsel.

Nov. 2—Proof of service filed by General Counsel (2).

Nov. 3—Motion for extension to Jan. 5, 1951, to prepare and transmit the record filed by General Counsel.

Nov. 3—Order enlarging time to Jan. 5, 1951, to prepare and transmit the record entered.

Dec. 21—Statement re diminution of record filed by General Counsel.

Dec. 21—Statement of points with statement of service filed by General Counsel.

[Title of Tax Court and Cause.]

Docket No. 15496

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his Notice of Deficiency (Bur. Symbols, Seattle IT:90D:DM), dated May 29th, 1947, and as a basis for his proceeding alleges as follows:

1. The petitioner is a citizen and resident of the United States, residing at 1061 East 88th, Seattle, Washington. The returns for the periods here involved were filed with the Collector of Internal Revenue for the Tacoma District of the State of Washington.

2. The notice of deficiency (a copy of which is attached hereto and marked Exhibit A) was mailed to the petitioner on May 29th, 1947.

3. The taxes in controversy are income taxes for the calendar years 1943, 1944 and 1945 and are in the total of $123,675.85.

4. The determination of tax set forth in the said notice of deficiency is based on the following errors:

(a) That the Commissioner erred in distributing the entire taxable income of the Western Construction Company, a limited partnership, to the three general partners of which the petitioner herein is one, instead of distributing the income ac-

cording to the interests of the limited partners as well as the general partners as per the returns of said limited and general partners.

(b) That the Commissioner erred in allowing only Fifteen Thousand Dollars as community income, one-half of which was reportable by petitioner's wife, for the reason that all of the income of said petitioner for the years 1943, 1944 and 1945 was community property.

(c) That the Commissioner erred in disallowing depreciation on personal auto, travel and auto expenses, auto insurance and entertainment, to the petitioner.

(d) That the Commissioner erred in including as income to the general partners for 1945 petitioner's pro rata share of the profits of a contract known as "Boeing Alterations" not completed by the partnership until 1946. That said partnership is on a "completed contract basis" and the gross profit was included erroneously in 1945 for the partnership, amounting to a total of $7,571.12, which should not have been included in said 1945 income of said partnership.

5. The facts upon which the petitioner relies as a basis of this proceeding are as follows:

(a) That prior to the taxable years above mentioned the petitioner as one of three general partners doing business under the name and style of Western Construction Company, formed a limited partnership under and by virtue of the laws of the State of Washington, taking into said limited part-

nership, among others, the petitioner's children, to wit: Winston A. Johnson, Elsie Keil and Vedola Johnson Kent. That said Winston A. Johnson, Elsie Keil and Vedola Johnson Kent, while a son and daughters of the petitioner were bona fide partners in said business conducted under the name of Western Construction Company, contributing additional capital and credit and/or personal services to said partnership. That said partnership was regularly and duly created as a limited partnership under the laws of the State of Washington and that said partners, Winston A. Johnson, Elsie Keil and Vedola Johnson Kent assumed their proportionate full liability for losses under the limited partnership laws of the State of Washington, if any should occur, to the full amount of their capital investment, and were entitled to their proportionate share of any profits. That the creation of said limited partnership was for a business purpose and that it was the intention of the general partners and of the limited partners to carry on said construction business as a partnership. That said limited partners at different times drew from said limited partnership different amounts from their share of the profits and used said amounts for their own personal uses.

(b) The Commissioner erred in allowing only the sum of Fifteen Thousand Dollars per annum as community income. That this Court on March sixth, 1947, entered a decision in the case of Albin Johnson vs. Commissioner of Internal Revenue, Docket

Number 5856 in which among other things this Court definitely decided in passing upon the very same state of facts as is presented by the Commissioner's restriction of community income herein, that Albin Johnson, the petitioner herein married Rose Chapman on March 8th, 1941, and that his income from the copartnership doing business as Western Construction Company prior to his marriage was the separate income of the petitioner, but that his income from said copartnership after his marriage, with an exception of a small allowance as a reasonable return on his share of borrowed capital, was community property divisible between himself and his wife. That said decision is the law of this case. That there is nothing in the facts in this case different as far as the community property and separate property status of Albin Johnson is concerned than in said case decided by this Court on March 6th, 1947. That all of the income of petitioner herein was the community property of Albin Johnson and Rose Johnson, his wife, and not his separate property.

(c) That the Commissioner erred in disallowing depreciation on personal auto, travel and auto expenses, auto insurance and entertainment. That the petitioner alleges that said automobile was used in the business of Western Construction Company as an ordinary and necessary expense by the taxpayer in the activities of his business and that the agreement among the general partners provided that each general partner pay these expenses personally.

Starting the first of 1945 this arrangement was changed so that the partnership paid the expenses of the cars, travel and entertainment but the partners should still provide their own cars; that the partnership owned no automobiles and that the cars of the general partners were the only cars available to carry on the business of the copartnership and that the particular cars upon which depreciation and expense were charged were used exclusively to carry on said copartnership business. That the entertainment of engineers and travel expense was also paid by each partner according to the agreement set forth above and as a regular and necessary expense of the petitioner in carrying on said copartnership business.

(d) That the Commissioner erred in including as income to the general partners for 1945 the petitioner's pro rata share of the profits of a contract known as "Boeing Alterations" not completed by the partnership until 1946. That said partnership is on a "completed contract basis" and the gross profit was included erroneously in 1945 for the partnership, amounting to a total of $7,571.12, which should not have been included in said 1945 income of said partnership.

6. That the Commissioner, the respondent herein, did, at approximately the same time that he gave notice of deficiency, distributing the entire taxable income of the Western Construction Company to the three general partners, gave another notice of deficiency to said limited partnership as

a whole alleging it to be an association and assessing said alleged association $594,735.72. That the total sum of said notices of deficiency, covering the Commissioner's distributing the entre taxable income of the limited partnership to the three general partners, and the assessment against the alleged association is more than the entire income of said limited partnership during said taxable years of 1943, 1944 and 1945. That the respondent herein should be required to make an election as to which course respondent wishes to pursue, to wit: to assess the entire taxable income of said limited partnership to the three general partners or to the limited partnership as an association—one or the other—prior to the hearing of this case upon its merits. That the Commissioner cannot in law or in equity at one and the same time distribute the income of the same entity to both the general partners and to an "association" composed of the general and limited partners.

Wherefore the petitioner prays that this Court may hear the proceeding and determine that the deficiency shown in the total amount of $123,675.85 as due from the petitioner for the years 1943, 1944 and 1945 should be voided and eliminated and that the petitioner be found not to be indebted to the United States Government for income taxes for said years.

/s/ RALPH B. POTTS,
Attorney for Petitioner.

State of Washington,
County of King—ss.

Ralph B. Potts and John H. Von Harten, being separately sworn, each for himself deposes and says: that he is one of the attorney-in-facts under power of attorney for petitioner above named; that he acts pursuant to such power-of-attorney and that such power has not been revoked; that the petitioner is absent from the United States and that affiant is authorized to verify this petition; that he has read the foregoing petition, or has had the same read to him, and is familiar with the statements contained therein, and that the statements contained therein are true, except those stated to be upon information and belief, and that those he believes to be true.

/s/ RALPH B. POTTS,

/s/ JOHN H. VON HARTEN.

Subscribed and sworn to before me this 30th day of July, 1947.

[Seal] /s/ LUCILLE POTTS,
Notary Public in and for the State of Washington,
Residing at Seattle.

Power of Attorney

Know All Men by These Presents, that the undersigned, Albin Johnson, does by these presents hereby make, constitute and appoint Ralph B. Potts and John H. Von Harten his true and lawful attorneys to appear before the Treasury Department and represent him in connection with his federal income taxes for the years of 1943, 1944 and 1945, with full power of substitution and revocation, giving his said attorneys full power to do everything whatsoever requisite and necessary to be done and execute waivers of the statute of limitations, and to execute closing agreements as fully as the undersigned might do if done in his own capacity, at any time subsequent to the date hereof and prior to the revocation hereof.

It is requested that a copy of all communications, addressed to the undersigned, regarding any matter in which the said attorneys are hereby authorized to act be addressed to John H. Von Harten, 1411 Fourth Avenue Building, Seattle 1, Washington.

In Witness Whereof, the undersigned has caused this instrument to be executed this 14th day of January, 1947.

/s/ ALBIN JOHNSON.

Subscribed and sworn to before me this 14th day of January, 1947.

[Seal] /s/ LUCILLE POTTS,
Notary Public.

EXHIBIT A

Treasury Department
Internal Revenue Service
Seattle 1, Washington

May 29th, 1947

Office of
Internal Revenue Agent in Charge,
Seattle Division,
305 A 1331 Third Avenue Building,

IT:90D:DM

Mr. Albin Johnson
605 Arctic Building,
Seattle, Washington

Dear Mr. Johnson:

You are advised that the determination of your income tax liability for the taxable years ended December 31, 1943, 1944 and 1945 discloses a deficiency of $123,675.85, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Saturday, Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington 25, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Seattle 1, Washington, for the attention of IT:90D:DM. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

JOSEPH D. NUNAN, JR.,
Commissioner.

By /s/ L. E. HALLOWELL,
Acting Internal Revenue
Agent in Charge.

DM:mts

Enclosures:
Statement
Form of Waiver

IT:90D:DM

STATEMENT

Mr. Albin Johnson
605 Arctic Building
Seattle, Washington

Tax liability for the taxable years ended December 31, 1943, D cember 31, 1944, and December 31, 1945.

Year		Deficiency
1943	Income tax	$ 93,780.81
1944	Income tax	6,717.05
1945	Income tax	23,177.99
		$123,675.85

In making this determination of your income tax liability, caref consideration has been given to the reports of examination dated Fe ruary 5, 1946, and September 16, 1946; to your protests dated Ap 17, 1946, January 14, 1947, and February 11, 1947; and to the stat ments made at the conferences held on June 12, 1946, and April 1 1947.

A copy of this letter and statement has been mailed to your rep sentative, Mr. John H. Von Harten, 1411 Fourth Avenue Buildin Seattle 1, Washington, in accordance with the authority contained the power of attorney executed by you.

In the computation of your net income for each year mention it is held that you are taxable upon one-third of the net income of t business conducted under the name of the Western Construction C Of this income, only the amount of $15,000.00 per annum is held constitute community income, one-half of which is reportable by yo wife. It is held that your children, Winston A. Johnson, Elsie K and Vedola Kent were not bona fide partners in the business co ducted under the name of the Western Construction Co. during t taxable years mentioned.

In the computation of your 1942 and 1943 tax liabilities you ha been allowed the full $1,200.00 marital exemption and credit for t dependent children, with credit for an additional dependent for thr months in 1943. For 1944 and 1945 you have been allowed a surt exemption of $500.00 for yourself and $500.00 for each of your thr dependent children.

Taxable Year Ended December 31, 1942

Adjustments to Net Income

Net income as disclosed by original return	$ 31,651.
Unallowable deductions and additional income:	
(a) Long-term capital gain	3,691.
(b) Business income increased	98,173.
(c) Personal expenses disallowed	1,160.
	$134,678.
Additional deductions and nontaxable income:	
(d) Contributions	92.
	$134,585.

Explanation of Adjustments

(a) Your income is increased to reflect the long-term capital gain : $3,691.47 derived from the exchange of your personally owned ıpital stock of the Western Construction Co. Inc.

(b) Your income is increased to reflect your corrected share of the ɛt income of the Western Construction Co. The community portion : such income is limited to the amount of $15,000.00 designated by greement, as the maximum salary payable to the individuals manag-g the business for their services.

orrected business income	$139,948.70
ess: Allocable to wife (one-half of $15,000)	7,500.00
axable to you	$132,448.70
eported in return	34,274.72
crease	$ 98,173.98

(c) Your income is increased by the disallowance of the following nsubstantiated items which do not constitute necessary business ex-enses to you:

epreciation on personal car	$ 280.74
ar expense	418.93
ar insurance	207.22
ntertainment of engineers, etc.	600.00
aveling expenses	480.00
tal	$1,986.89
ss: One-half claimed on spouse's return	993.45
aimed and disallowed	$ 993.44

our income is further increased by the disallowance of alimony pay-nts made in excess of that required by your divorce decree.

imony claimed (one-half of $1,535.00)	$ 767.50
llowable	600.00
	$ 167.50
tal personal expenses disallowed	$1,160.94

(d) Your income is decreased to allow for additional charitable ntributions, as follows:

Contributions substantiated and allowable:

ne-half of community church contributions	$ 500.00
ne-third of Western Construction Co. charitable contributions	226.29
tal allowable	726.29
imed in return	633.50
ditional amount allowed	$ 92.79

Computation of Tax

Your tax liability is correctly computed under the alternative tax method as follows:

1.	Net income		$134,585.57
2.	Minus: Excess of net long-term capital gain over net short-term capital loss		3,691.47
3.	Ordinary net income		$130,894.10
4.	Less: Personal exemption	$ 1,200.00	
5.	Credit for dependents	700.00	1,900.00
6.	Balance (surtax net income)		$128,994.10
8.	Less: Earned income credit		1,400.00
9.	Balance subject to normal tax		$127,594.10
10.	Normal tax at 6 per cent	$ 7,655.65	
11.	Surtax on item 6	82,045.34	$ 89,700.99
12.	Partial tax		$ 89,700.99
13.	Plus: 50% of line 2		1,845.71
14.	Alternative tax		$ 91,546.70
15.	Correct tax on 1942 income		91,546.70

Taxable Year Ended December 31, 1943

Adjustments to Net Income

	Income Tax Net Income	Victory Tax Net Income
As disclosed by return	$ 30,023.33	$ 30,192.1
Unallowable deductions and additional income:		
(a) Business income increased	84,722.52	84,733.5
(b) Personal expenses disallowed	1,860.92	1,860.9
	$116,617.77	$116,786.0
(c) Contributions	319.93	—0—
	$116,297.84	$116,786.0

Explanation of Adjustments

(a) Your income is increased to reflect your corrected share of the net income of the Western Construction Co. The community portion of such income is limited to the amount of $15,000.00 designated by agreement as the maximum salary payable to the individuals managing the business for their service.

Corrected business income		$124,886.63
Less: Allocable to wife (one-half of $15,000)		7,500.00
Taxable to you		$117,386.63
Reported in return		32,653.11
Increase		$ 84,733.52

(b) Your income is increased by the disallowance of the following unsubstantiated items which do not constitute necessary business expenses to you:

Car depreciation	$ 280.74
Car insurance	162.89
Entertainment	1,994.42
Traveling	928.74
Total	$3,366.79
Less: One-half claimed by spouse	1,683.39
Claimed and disallowed	$1,683.40

Your income is further increased by the disallowance of alimony payments made in excess of that required by your divorce decree.

Alimony claimed (one-half of $1,555.05)	$777.52	
Allowable	600.00	
Disallowed		177.52
Total personal expense disallowed		$1,860.92

(c) Your income is decreased to allow for additional charitable contributions as follows:

One-half of community contributions to Red Cross	$ 1.50
One-third of Western Construction Co. charitable contributions	416.66
Total allowable	$ 418.16
Claimed in return	98.23
Additional allowed	$ 319.93

1.	Income tax net income		$116,297.8
2.	Less: Personal exemption	$ 1,200.00	
	Credit for dependents	787.50	1,987.5
3.	Surtax net income		$114,310.3
4.	Less: Earned income credit		1,400.0
5.	Balance subject to normal tax		$112,910.3
6.	Normal tax at 6 per cent	$ 6,774.62	
7.	Surtax on Item 3	70,445.17	
8.	Total income tax (item 6 plus item 7)		77,219.7
10.	Balance of income tax		77,219.7
11.	Victory tax net income	$116,786.63	
12.	Less: Specific exemption	624.00	
13.	Income subject to victory tax	$116,162.63	
14.	Victory tax before credit (5% of line 13)	$ 5,808.13	
15.	Less: Victory tax credit, $500.00 plus 2¼ × $100.00	725.00	5,083.1
16.	Net victory tax		
17.	Net income tax and victory tax		$ 82,302.9
18.	Income tax for 1942		$ 91,546.7
19.	Amount of item 17 or 18 whichever is larger		$ 91,546.7
20.	Forgiveness feature:		
	(a) Amount of item 17 or 18 whichever is smaller	$ 82,302.92	
	(b) Amount forgiven (¾ of (a))	61,727.19	
	(c) Amount unforgiven		20,575.7
21.	Total income and victory tax liability		$112,122.4
22.	Income and victory tax liability disclosed by return, Account =6350172		18,341.6
23.	Deficiency in income and victory tax		$ 93,780.8

Taxable Year Ended December 31, 1944

Adjustments to Net Income

Net income as disclosed by return	$ 10,136.18
Unallowable deductions and additional income:	
(a) Business income increased	12,825.72
(b) Long-term capital gain increased	52.26
(c) Personal expenses disallowed	1,156.48
Net income as adjusted	$ 24,170.64

Explanation of Adjustments

(a) Your income is increased to reflect your corrected share of the net income of the Western Construction Co. The community portion of such income is limited to the amount of $15,000.00 designated by agreement as the maximum salary payable to the individuals managing the business for their services.

Corrected business income	$ 32,100.97
Less: Allocable to wife (one-half of $15,000)	7,500.00
Taxable to you	$ 24,600.97
Reported in return	11,775.25
Increase	$ 12,825.72

(b) Your income is increased to reflect your corrected share of the long-term capital gain of the Western Construction Co. as follows:

One-third of Western Construction Co. long term capital gain	$ 69.68
Reported in return (one-half of $34.84)	17.42
	$ 52.26

(c) Your income is increased by the disallowance of the following unsubstantiated items which do not constitute necessary business expenses to you:

Depreciation on personal automobile	$ 280.74
Automobile expenses	710.06
Entertainment and travel	1,322.17
Total	$2,312.97
Less: One-half claimed on spouse's return	1,156.48
Claimed and disallowed	1,156.48

Computation of Tax

Your correct tax liability is computed under the alternative tax method as follows:

1.	Net income	$24,170.64
2.	Minus: Excess of net long-term capital gain over net short-term capital loss	69.68
3.	Ordinary net income	$24,100.96
4.	Less: Surtax exemptions	2,000.00
5.	Balance (surtax net income)	$22,100.96
6.	Surtax on line 5	$ 8,439.57
7.	Ordinary net income	$24,100.96
8.	Less: Normal-tax exemption	500.00
9.	Balance subject to normal tax	$23,600.96
10.	Normal tax at 3 per cent	$ 708.03
11.	Partial tax (sum of lines 6 and 10)	$ 9,147.60
12.	Plus: 50% of line 2	34.84
13.	Alternative tax	$ 9,182.44
14.	Correct tax liability	$ 9,182.44
15.	Income tax liability disclosed by return, Account #9002365	2,465.39
16.	Deficiency in income tax	$ 6,717.05

Taxable Year Ended December 31, 1945

Adjustments to Net Income

Net income as disclosed by return	$19,860.32
Unallowable deductions and additional income:	
(a) Business income increased	34,871.44
(b) Long-term capital gain increased	900.67
(c) Personal expenses disallowed	140.36
Total	$55,772.79
Nontaxable income and additional deductions:	
(d) Interest income decreased	1,076.65
Net income as adjusted	$54,696.14

Explanation of Adjustments

(a) Your income is increased to reflect your corrected share of the net income of the Western Construction Company. The community portion of such income is limited to the amount of $15,000.00 designated by agreement as the maximum salary payable to the individuals managing the business for their services.

Corrected business income		$61,495.25
Less: Allocable to wife (one-half of $15,000)		7,500.00
		$53,995.25
Reported in return		19,123.81
Increase		$34,871.44

(b) Your income is increased to reflect your corrected share of the long-term capital gain of the Western Construction Co. as follows:

One-third of Western Construction Co. long-term capital gain		$ 1,200.89
Reported in return (one-half of $600.44)		300.22
		$ 900.67

(c) Your income is increased by the disallowance of the following unsubstantiated items which do not constitute necessary business expenses to you:

Depreciation on personal automobile		$ 280.72
Less: One-half claimed by spouse		140.36
		$ 140.36

(d) Your income is decreased by the elimination of so-called interest reported as having been received from your children as follows:

Winston A. Johnson	$876.65	
Elsie Keil	876.65	
Tedola Kent	400.00	$ 2,153.30
Total		
Less: One-half reported by spouse		$ 1,076.65
		$ 1,076.65

Since the transactions under which the purported liability of the children arose has been held to be ineffectual for income tax purposes, the interest entries are likewise held to be without substance and do not represent taxable income.

Computation of Tax

Your tax liability is correctly computed under the alternative tax method as follows:

1.	Net income	$54,696.14
2.	Minus: Excess of net long-term capital gain over net short-term capital loss	1,200.89
3.	Ordinary net income	$53,495.25
4.	Less: Surtax exemptions	2,000.00
5.	Balance (surtax net income)	$51,495.25
6.	Surtax on line 5	27,941.44
7.	Ordinary net income	53,495.25
8.	Less: Normal tax exemption	500.00
9.	Balance subject to normal tax	$52,995.25
10.	Normal tax at 3 per cent	$ 1,589.86
11.	Partial tax (sum of lines 6 and 10)	$29,531.30
12.	Plus: 50% of line 2	600.45
13.	Alternative tax	$30,131.75
14.	Correct tax liability	$30,131.75
15.	Income tax liability disclosed by return #3011862	6,953.76
16.	Deficiency	$23,177.99

Received and Filed T.C.U.S. August 11, 1947.

[Title of Tax Court and Cause.]

Docket No. 15496

ANSWER

Now comes the Commissioner of Internal Revenue, by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed herein, admits, alleges and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits the allegations contained in paragraph 3 of the petition.

4(a), (b), (c) and (d). Denies that in determining the deficiencies asserted for the taxable years involved the respondent committed any errors, and specifically denies the allegations of error and of fact contained in subparagraphs (a), (b), (c) and (d) of paragraph 4 of the petition.

5(a). Admits that petitioner, as one of three alleged general partners doing business under the name and style of Western Construction Company, in 1942 and 1943 purported to enter into certain limited partnerships and, among others, pretended to take into said business, as limited partners, petitioner's children, to wit: Winston A. Johnson, Elsie Keil and Vedola Johnson Kent. Denies each and every other material allegation contained in subparagraph (a) of paragraph 5 of the petition.

5(b). Admits that this Court on March 6, 1947, issued a memorandum opinion in the case of Albin Johnson v. Commissioner of Internal Revenue, Docket No. 5856 wherein it determined the amount of petitioner's separate and community income for the taxable year 1941 from certain copartnership from which income was derived in that year. Denies each and every other material allegation of error

and of fact contained in subparagraph (b) of paragraph 5 of the petition.

5(c) and (d). Denies each and every material allegation of error and of fact contained in subparagraphs (c) and (d) of paragraph 5 of the petition.

6. Admits that at approximately the same time as respondent issued the notice of deficiency in this proceeding determining the portion of the income of the Western Construction Company, which is includible, for Federal tax purposes in the return of this petitioner for the years involved, the Commissioner also issued a notice of deficiency to the Western Construction Company asserting against it deficiencies in Federal income, declared value excess profits taxes and excess profits taxes on the basis that it is an association taxable as a corporation under the Federal revenue laws for the taxable years 1942 to 1945, inclusive. Alleges that the aggregate of the deficiencies so asserted against the said Western Construction Company, for the years stated, amounts to $728,832.16 instead of $594,735.72 as alleged by petitioner. Denies each and every other material allegation contained in paragraph 6 of the petition.

7. Denies generally and specifically each and every material allegation contained in the petition, not hereinbefore specifically admitted, qualified or denied.

Wherefore, it is prayed that the petitioner's ap-

peal be denied, and that the Commissioner's determination of deficiencies be approved.

/s/ CHARLES OLIPHANT, WHP.
Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:
B. H. NEBLETT,
Division Counsel.

WILFORD H. PAYNE,
Special Attorney,
Bureau of Internal Revenue.

Received and Filed T.C.U.S. October 1, 1947.

[Title of Tax Court and Cause.]

Docket No. 15496

AMENDMENT TO RESPONDENT'S ANSWER

Now comes the Commissioner of Internal Revenue, by his attorney Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, in accordance with Rule 17 of the Court's Rules of Practice and pursuant to oral motion on behalf of respondent which was granted by the Honorable Eugene Black, Judge of the Tax Court of the United States, at the hearing of this proceeding at Seattle, Washington, under date of May 26, 1948, by way of amendment to respondent's answer heretofore filed in the above-entitled cause and in order to conform his answer

to the proof in the case, respectfully alleges and pleads, in the alternative, as follows:

8. In the event the Court should hold and determine that the limited partnership agreement with respect to Western Construction Company, which was executed February 24, 1942, and purporting to be effective as of January 2, 1942, should be recognized and given effect for Federal tax purposes as to the so-called limited partners, rather than taxing the entire partnership income to the general partners (and their spouses), then:

(a). The three equal general partners, J. A. Johnson, George J. Johnson and Albin Johnson, are subject to tax with respect to one-half of the distributive partnership income (1/6 to each general partner) for the period January 2, 1942, to June 30, 1943 (the latter being the effective date of the second limited partnership agreement), instead of 45/105ths thereof (15/105ths as to each general partner) for the period during which the first limited partnership agreement was in effect, as reported in the individual income tax returns of said general partners and their spouses for the taxable years 1942 and 1943.

(b). Respondent hereby makes claim to any increase in the deficiency heretofore determined with respect to this petitioner which may result, as to each of the taxable years 1942 and 1943, by taxing each of the general partners (and his spouse) on 1/6 of the partnership income rather than 15/105ths

thereof for the period January 2, 1942, to June 30, 1943.

(c). Effect may be given to respondent's alternative contention herein under a Rule 50 computation to be later submitted, in the event the decision of the Court with respect to the issues presented should require it, inasmuch as a Rule 50 computation will be necessary in any event in order to give effect to certain stipulations and concessions made by the parties at the hearing as to adjustments of income for the years 1942 and 1943.

Wherefore, it is prayed that petitioner's appeal be denied and that respondent's determination be sustained.

/s/ CHARLES OLIPHANT, WHP
Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel.

WILFORD H. PAYNE,
Special Attorney,
Bureau of Internal Revenue.

Received and filed T.C.U.S. June 15, 1948.

Served June 17, 1948.

The Tax Court of the United States
Washington

Docket No. 15496

ALBIN JOHNSON,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the determination of the Court as set forth in its Findings of Fact and Opinion promulgated March 22, 1950, the respondent herein filed a computation on June 1, 1950, which was not contested by petitioner when called for hearing July 13, 1950, now therefore, it is

Ordered and Decided: that there are deficiencies in income tax for the calendar years 1943, 1944 and 1945 in the respective amounts of $9,311.96, $834.40 and $2,667.06.

[Seal] /s/ EUGENE BLACK,
Judge.

Entered July 14, 1950.

Served July 14, 1950.

In the United States Court of Appeals
for the Ninth Circuit

T. C. Docket No. 15496

COMMISSIONER OF INTERNAL REVENUE,
Petitioner on Review,

vs.

ALBIN JOHNSON,
Respondent on Review.

PETITION FOR REVIEW

To the Honorable Judges of the United States Court of Appeals for the Ninth Circuit:

The Commissioner of Internal Revenue hereby petitions the United States Court of Appeals for the Ninth Circuit to review the decision entered by The Tax Court of the United States on July 14, 1950, that there are deficiencies for the calendar years 1943, 1944 and 1945 in the respective amounts of $9,311.96, $834.40 and $2,667.06 in respect of the Federal income tax liability of Albin Johnson, the above-named respondent on review. This petition for review is filed pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

The respondent on review, Albin Johnson, is a citizen of the United States, residing at 1061 East 88th Street, Seattle, Washington, and having a place of business at 605 Arctic Building, Seattle, Washington. Respondent filed his Federal income tax

returns for the years 1943, 1944 and 1945, the taxable years here involved, with the Collector of Internal Revenue for the District of Washington, whose office is located in Tacoma, Washington, and within the jurisdiction of the United States Court of Appeals for the Ninth Circuit where this review is sought.

Nature of Controversy

The respondent on review, Albin Johnson was, during the taxable years here involved, one of the general partners of the Western Construction Company. The Western Construction Company was created as a limited partnership under the laws of the State of Washington in 1942 and again in 1943. Its certificate of formation included J. A. Johnson, George Johnson and Albin Johnson, three brothers, as its general partners and their several adult sons and daughters as limited partners. The partnership was engaged during the taxable years here involved in the general contracting business. Prior to its organization the business had been conducted by a predecessor corporation known as Western Construction Company, Inc. In his determination of deficiencies in income, declared value excess profits, and excess profits taxes against the partnership, the Commissioner determined that the Western Construction Company, under the so-called limited partnership agreements of February 24, 1942, and June 30, 1943, constituted an association taxable as a corporation as prescribed by Section 3797(a)(3)

of the Internal Revenue Code and Section 29.3797-5 of Regulations 111, and that the so-called partnership or association, rather than its individual members, was taxable on the income earned by it during the calendar years 1942 to 1945, inclusive. In the alternative, it was determined by the Commissioner that if the Western Construction Company was recognizable as a valid partnership, for Federal income tax purposes, its income was taxable entirely to its three general partners, one of whom was the respondent on review herein, rather than being taxable on a distributable basis to said general partners and the ten alleged limited partners, children of the three general partners.

The Tax Court of the United States disagreed with the Commissioner's determination and held that the Western Construction Company was a bona fide partnership composed of the three Johnson brothers and their several children as set out in the certificate of formation of the partnership and that it should be so recognized for tax purposes. Accordingly, in conformity with its opinion, the Tax Court entered its decision that there are no deficiencies in income tax, declared value excess profits tax and excess profits tax for the calendar years 1942, 1943, 1944 and 1945 in respect of the partnership and, as to the respondent on review herein, Albin Johnson, refused to hold that his three children were not taxable on their shares of the partner-

ship income and that such shares were taxable to their father, the respondent herein.

/s/ THERON L. CAUDLE, C.A.R.
Assistant Attorney General.

/s/ CHARLES OLIPHANT, C.A.R.
Chief Counsel, Bureau of Internal Revenue, Attorneys for Petitioner on Review.

Received and filed T.C.U.S. October 9, 1950.

[Title of Court of Appeals and Cause.]

T. C. Docket No. 15496

STATEMENT OF POINTS

Comes Now the Commissioner of Internal Revenue, petitioner on review in the above-entitled cause, by and through his attorneys, Theron L. Caudle, Assistant Attorney General, and Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, and hereby states that he intends to rely upon the following points in this proceeding:

The Tax Court of the United States erred:

1. In entering its decision that there are deficiencies in income tax for the calendar years 1943, 1944 and 1945 in the respective amounts of only $9,311.96, $834.40 and $2,669.06.

2. In failing and refusing to sustain the deficiencies in tax determined by the Commissioner on

the basis that the taxpayer was taxable upon one-third of the net income of the business conducted under the name of Western Construction Company, less the community portion of such income allocable to taxpayer's wife, as modified by stipulation and agreement of the parties in respect of items not now in controversy.

3. In holding and deciding that the Western Construction Company is a bona fide partnership composed of the three Johnson brothers and their several children as set out in the certificate of formation of the partnership and is recognized as such for tax purposes.

4. In failing and refusing to hold and decide that the Western Construction Company, during the taxable years involved, was a partnership consisting only of its three general partners, and that for Federal income tax purposes the income of such partnership was taxable to the general partners and their respective spouses and that the children of the general partners should not be recognized, for Federal income tax purposes, as bona fide partners in the business conducted by the said Western Construction Company.

5. In that its opinion and its decision that, for Federal income tax purposes, the Western Construction Company is a bona fide partnership composed of the three Johnson brothers and their several children as set out in the certificate of formation of

the partnership is not supported by but is contrary to the evidence.

6. In that its opinion and its decision are not supported by but are contrary to the evidence.

7. In that its opinion and its decision are contrary to law and the Commissioner's regulations.

/s/ THERON L. CAUDLE,
Assistant Attorney General.

/s/ CHARLES OLIPHANT,
Chief Counsel, Bureau of Internal Revenue, Attorneys for Petitioner on Review.

Statement of Service attached.

Received and filed T.C.U.S. December 21, 1950.

The Tax Court of the United States

Docket No. 15497

ELLEN M. JOHNSON,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

1947

Aug. 11—Petition received and filed. Taxpayer notified. Fee paid.

Aug. 12—Copy of petition served on General Counsel.

Oct. 1—Answer filed by General Counsel.

Oct. 1—Request for hearing in Seattle filed by General Counsel.

Oct. 10—Notice issued placing proceeding on Seattle, Wash., calendar. Service of answer and request made.

1948

Mar. 23—Hearing set 5/17/48, Seattle, Wash.

May 24, 25 & 26—Hearing had before Judge Black on merits—consolidated, cases to be kept open to receive claim for refund. Respondent to file amendment to answer by 6/20/48; pe-

1948

titioner's reply 7/10/48, stipulation of facts filed, briefs due 8/15/48; replies 9/15/48.

June 15—Amendment to respondent's answer filed by General Counsel.

July 12—Transcript of hearing May 24, 1948, filed.

July 12—Transcript of hearing May 25, 1948, filed.

July 12—Transcript of hearing May 26, 1948, filed.

Aug. 9—Motion for extension to 9/1/48 to file brief filed by taxpayer. 8/10/48. Granted.

Aug. 30—Motion for extension to 9/20/48 to file both briefs filed by taxpayer. 8/31/48 Granted.

Aug. 30—Entry of appearance of Carbery O'Shea as counsel filed.

Sept. 8—Brief filed by General Counsel.

Sept. 16—Motion for extension to Oct. 5, 1948, to file brief filed by taxpayer. Granted.

Oct. 5—Brief filed by taxpayer. Copy served.

Nov. 1—Reply brief filed by taxpayer. Copy served.

Nov. 5—Reply brief filed by General Counsel.

1950

Mar. 22—Findings of fact and opinion rendered, Black, J. Decision will be entered under rule 50. Copy served 2/23/50.

June 1—Respondent's computation filed.

June 6—Hearing set July 13, 1950, on respondent's computation.

July 13—Hearing had before Judge Kern on settlement, uncontested, referred to J. Black.

July 14—Decision entered, Black, J., Div. 15.

Oct. 9—Petition for review by U. S. Court of Appeals, 9th Circuit, filed by General Counsel.

Nov. 2—Proof of service filed by General Counsel. (2).

Nov. 2—Affidavit of service of petition for review filed.

Nov. 3—Motion for extension to Jan. 5, 1951, to prepare and transmit the record filed by General Counsel.

Nov. 3—Order enlarging time to Jan. 5, 1951, to prepare and transmit the record entered.

Dec. 21—Statement re diminution of record filed by General Counsel.

Dec. 21—Statement of points with statement of service thereon filed by General Counsel.

The Tax Court of the United States

Docket No. 15497

ELLEN M. JOHNSON,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his Notice of Deficiency (Bur. Symbols, Seattle IT:90D:DM) dated May 29th, 1947, and as a basis for her proceeding alleges as follows:

1. The petitioner is a citizen and resident of the United States, residing at 1619 East 52nd, Seattle, Washington. The returns for the periods here involved were filed with the Collector of Internal Revenue for the Tacoma District of the State of Washington.

2. The notice of deficiency (a copy of which is attached hereto and marked Exhibit A) was mailed to the petitioner on May 29th, 1947.

3. The taxes in controversy are income taxes for the calendar years 1943, 1944 and 1945 and are in the total amount of $38,467.40.

4. The determination of tax set forth in the said notice of deficiency is based on the following errors:

(a) That the Commissioner erred in distributing the entire taxable income of the Western Construction Company, a limited partnership, to the three general partners, one of whom is the husband of the petitioner herein, instead of distributing the income according to the interests of the limited partners as well as the general partners as per the returns of said limited and general partners. That the general partner, J. A. Johnson and your petitioner are husband and wife, and as such constitute a marital community and under the community property laws of the State of Washington have made separate returns, equally dividing the community income in half, your petitioner therefore making a return of one-half of the community income.

(b) That the Commissioner erred in disallowing depreciation on the personal auto of J. A. Johnson, husband of the petitioner herein, travel and auto expenses, auto insurance and entertainment, to the petitioner.

(c) That the Commissioner erred in including as income to the general partners of the Western Construction Company for 1945, the petitioner's pro rata share of the profits of a contract known as "Boeing Alterations" not completed by the partnership until 1946. That said partnership is on a "completed contract basis" and the gross profit was included erroneously in 1945 for the partnership, amounting to a total of $7,571.12, which should not have been included in said 1945 income of said partnership.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) That prior to the taxable years above mentioned the petitioner was the wife of J. A. Johnson, one of three general partners doing business under the name and style of Western Construction Company who formed a limited partnership under and by virtue of the laws of the State of Washington, taking into said limited partnership, among others, the petitioner's children, to wit: Roy W. Johnson, Evelyn Jorgens and Eleanor Rector. That said Roy W. Johnson, Evelyn Jorgens and Eleanor Rector, while a son and daughters of the petitioner were bona fide partners in said business conducted under the name of Western Construction Company, contributing additional capital and credit and/or personal services to said partnership. That said partnership was regularly and duly created as a limited partnership under the laws of the State of Washington, and that said partners, Roy W. Johnson, Evelyn Jorgens and Eleanor Rector assumed their proportionate full liability for losses, if any should occur, to the full amount of their capital investment under the limited partnership laws of the State of Washington, and were entitled to their proportionate share of any profits. That the creation of said limited partnership was for a business purpose and that it was the intention of the general partners and of the limited partners to carry on said construction business as a partnership. That said limited partners at different times drew from said limited partnership different amounts from their

share of the profits and used said amounts for their own personal use.

(b) That the Commissioner erred in disallowing depreciation on personal auto, travel and auto expenses, auto insurance and entertainment. That the petitioner alleges that said automobile was used by her husband, J. A. Johnson, in the business of Western Construction Company as an ordinary and necessary expense in the activities of his business and that the agreement among the general partners provided that each general partner pay these expenses personally. Starting the first of 1945 this arrangement was changed so that the partnership paid the expenses of the cars, travel and entertainment, but the partners should still provide their own cars; that the partnership owned no automobiles and that the cars of the general partners were the only cars available to carry on the business of the copartnership and that the particular cars upon which depreciation and expense were charged were used exclusively to carry on said copartnership business. That the entertainment of engineers and travel expense was also paid by each partner according to the agreement set forth above and as a regular and necessary expense of the husband of the petitioner in carrying on said copartnership business.

(c) That the Commissioner erred in including as income to the general partners of the Western Construction Company for 1945, the petitioner's pro rata share of the profits of a contract known as "Boeing Alterations" not completed by the partnership until 1946. That said partnership is on a "com-

pleted contract basis" and the gross profit was included erroneously in 1945 for the partnership, amounting to a total of $7,571.12, which should not have been included in said 1945 income of said partnership.

6. That the Commissioner, the respondent herein, did, at approximately the same time that he gave notice of deficiency, distributing the entire taxable income of the Western Construction Company to the three general partners, gave another notice of deficiency to said limited partnership as a whole alleging it to be an association and assessing said alleged association $594,735.72. That the total sum of said notices of deficiency covering the Commissioner's distributing the entire taxable income of the limited partnership to the three general partners, and the assessment against the alleged association is more than the entire income of said limited partnership during said taxable years of 1943, 1944 and 1945. That the respondent herein should be required to make an election as to which course respondent wishes to pursue, to wit: to assess the entire taxable income of said limited partnership to the three general partners or to the limited partnership as an association—one or the other—prior to the hearing of this case upon its merits. That the Commissioner cannot in law or in equity at one and the same time distribute the income of the same entity to both the general partners and to an "association" composed of the general and limited partners.

Wherefore the petitioner prays that this Court

may hear the proceeding and determine that the deficiency shown in the total amount of $38,467.40 as due from the petitioner for the years 1943, 1944 and 1945, should be voided and eliminated and that the petitioner be found not to be indebted to the United States Government for income taxes for said years.

/s/ RALPH B. POTTS,
Attorney for Petitioner.

State of Washington,
County of King—ss.

Ellen M. Johnson, being, first duly sworn, says that she is the petitioner above named; that she has read the foregoing petition, or has had the same read to her, and is familiar with the statements contained therein, and that the statements contained therein are true, except those stated to be upon information and belief, and that those she believes to be true.

/s/ ELLEN M. JOHNSON.

Subscribed and sworn to before me this 30th day of July, 1947.

[Seal] /s/ LUCILLE POTTS,
Notary Public in and for the State of Washington,
Residing at Seattle.

EXHIBIT A

Treasury Department
Internal Revenue Service
Seattle 1, Washington

May 29, 1947.

Seattle Division,
305 A 1331 Third
Ave. Building,

IT:90D:DM.

Mrs. Ellen M. Johnson,
605 Arctic Building,
Seattle 4, Washington.

Dear Mrs. Johnson:

You are advised that the determination of your income tax liability for the taxable years ended December 31, 1943, 1944, and 1945, discloses a deficiency of $38,467.40, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Saturday, Sunday or a legal holiday in the District of Columbia as the the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington 25, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Seattle 1, Washington, for the attention of IT:90D:DM. The signing and filing of this form will expedite the closing of your returns by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

JOSEPH D. NUNAN, JR.,
Commissioner.

By /s/ L. E. HOLLOWELL,
Acting Internal Revenue
Agent in Charge.

DM:mts

Enclosures:
Statement
Form of Waiver

IT:90D:DM

STATEMENT

Mrs. Ellen M. Johnson
605 Arctic Building
Seattle, Washington

Tax liability for the taxable years ended December 31, 1943, December 31, 1944, and December 31, 1945.

Year		
1943	Income tax	$29,624.73
1944	Income tax	2,312.86
1945	Income tax	6,529.81
	Total	$38,467.40

In making this determination of your income tax liability, careful consideration has been given to the reports of examination dated February 5, 1946, and September 16, 1946; to your protests dated April 17, 1946, January 14, 1947, and February 11, 1947; and to the statements made at the conferences held on June 12, 1946, and April 14, 1947.

A copy of this letter and statement has been mailed to your representative, Mr. John H. Von Harten, 1411 Fourth Avenue Building, Seattle 1, Washington, in accordance with the authority contained in the power of attorney executed by you.

In the computation of your net income for each year mentioned it is held that you and your spouse are each taxable upon one-sixth of the net income of the business conducted under the name of Western Construction Co. It is held that for income tax purposes your children (Roy W. Johnson, Evelyn L. Jorgens and Eleanor J. Rector) were not bona fide partners in the business conducted under the name of Western Construction Co. during the taxable years mentioned.

Taxable Year Ended December 31, 1942

Adjustments to Net Income

Net income as disclosed by original return		$27,457.3
Unallowable deductions and additional income:		
(a) Long-term capital gain	$ 1,845.74	
(b) Business income increased	35,699.63	
(c) Personal expenses disallowed	1,038.95	38,584.3
		$66,041.7
Additional deductions and nontaxable income:		
(d) Contributions increased		64.6
Net income as adjusted		$65,977.0

Explanation of Adjustments

(a) Your income is increased to reflect your one-half share of the ong-term capital gain of $3,691.47 upon the exchange of community wned capital stock of the Western Construction Co., Inc.

(b) Your income is increased to reflect your corrected share of ncome of the Western Construction Co.

Such income is held to be community income and one-half thereof axable to your spouse. Increase in your income is computed as fol-ows:

ne-sixth of corrected Western Construction Co. net income	$69,974.35
eported in return	34,274.72
ncrease	$35,699.63

(c) Your income is increased by the disallowance of the following nsubstantiated items which do not constitute necessary business ex-enses to you:

epreciation on personal auto	$ 300.00
ar operating expense	494.64
ar insurance	203.27
ntertainment of engineers, etc.	600.00
ravel expense	480.00
	$ 2,077.91
ess: One-half claimed by spouse	1,038.96
alance claimed by taxpayer and disallowed	$ 1,038.95

(d) Your income is decreased to allow for additional charitable ntributions to be taken into account from the Western Construction o. as follows:

ne-sixth of Western Construction Co. contributions	$ 113.16
laimed in return	48.49
dditional allowance	$ 64.66

Computation of Tax

Your tax liability is correctly computed under the alternative tax ethod as follows:

. Net income	$65,977.04
. Minus: Excess of net long-term capital gain over net short-term capital loss	1,845.73
. Ordinary net income	$64,131.31
. Less: Personal exemption	600.00
. Balance (surtax net income)	$63,531.31
. Less: Earned income credit	1,396.01

9. Balance subject to normal tax		$62,135.30
10. Normal tax at 6 per cent	$ 3,728.12	
11. Surtax on item 6	32,276.60	
12. Partial tax		$36,004.72
13. Plus: 50% of line 2		922.86
14. Alternative tax		$36,927.58
15. Tax liability on 1942 income		$36,927.58

Taxable Year Ended December 31, 1943

Adjustments to Net Income

	Income Tax Net Income	Victory Tax Net Income
Net income as disclosed by return	$29,960.02	$31,321.46
Unallowable deductions and additional income:		
(a) Business income increased	$29,790.26	29,790.26
(b) Personal expenses disallowed	1,478.60	1,478.60
Total	$61,228.88	
Additional deductions and nontaxable income:		
(c) Contributions	111.62	—0—
Net income as adjusted	$61,117.26	$62,590.32

Explanation of Adjustments

(a) Your income is increased to reflect your corrected share of income of the Western Construction Co.

Such income is held to be community income and one-half thereof taxable to your spouse. Increase in your income is computed as follows:

One-sixth of corrected Western Construction Co. net income	$62,443.37
Reported in return	32,653.17
Increase	$29,790.20

(b) Your income is increased by the disallowance of the following unsubstantiated items which do not constitute necessary business expenses to you:

Depreciation on personal auto	$ 300.00
Travel and auto expenses	1,232.00
Auto insurance	140.90
Entertainment	1,284.20
	$ 2,957.20
Less: One-half claimed by spouse	1,478.60
Balance disallowed	$ 1,478.60

(c) Your income is decreased to allow for additional charitable contributions to be taken into account from the Western Construction Co. as follows:

One-sixth of Western Construction Co. contributions	$ 208.34
Claimed in return	96.72
Additional allowance	$ 111.62

Computation of Income and Victory Tax

1.	Income tax net income		$61,117.26
2.	Less: Personal exemption		600.00
3.	Surtax net income		$60,517.26
4.	Less: Earned income credit		1,251.81
5.	Balance subject to normal tax		$59,265.45
6.	Normal tax at 6 per cent	$ 3,555.93	
7.	Surtax on item 3	30,196.91	
8.	Total income tax (item 6 plus item 7)		$33,752.84
10.	Balance of income tax		$33,752.84
11.	Victory tax net income	$62,590.32	
12.	Less: Specific exemption	624.00	
13.	Income subject to victory tax	$61,966.32	
14.	Victory tax before credit (5% of line 13)	$ 3,098.32	
15.	Less: Victory tax credit	500.00	
16.	Net victory tax		2,598.32
17.	Net income tax and victory tax		$36,351.16
18.	Income tax for 1942		$36,927.58
20.	Forgiveness feature:		
	(a) Amount of item 17 or 18 whichever is smaller	$36,351.16	
	(b) Amount forgiven (¾ of (a))	27,263.37	
	(c) Amount unforgiven		9,087.79
21.	Total income and victory tax liability		$46,015.37
22.	Income and victory tax liability disclosed by return, Account #6350167		16,390.64
23.	Deficiency in income victory tax		$29,624.73

Taxable Year Ended December 31, 1944

Adjustments to Net Income

Net income as disclosed by return	$ 9,136.1
Unallowable deduction and additional income:	
(a) Business income increased	4,275.2
(b) Long-term capital gain increased	17.4
(c) Personal expenses disallowed	1,267.2
Total	$14,696.0
Additional deductions and nontaxable income:	
(d) Contributions	59.5
Income as adjusted	$14,636.4

Explanation of Adjustments

(a) Your income is increased to reflect your corrected share o income of the Western Construction Co.

Such income is held to be community income and one-half thereo taxable to your spouse. Increase in your income is computed as fol lows:

One-sixth of corrected Western Construction Co. net income	$16,050.4
Reported in return	11,775.2
Increase	$ 4,275.2

(b) Your income is increased to reflect your corrected share of the Western Construction Co. long-term capital gain as follows:

One-sixth of Western Construction Co. long-term capital gain	$ 34.8
Reported in return	17.4
Increase	$ 17.4

(c) Your income is increased by the disallowance of the follow ing unsubstantiated items which do not constitute necessary busines expenses to you:

Depreciation on personal auto	$ 300.0
Car operating expense	742.5
Entertainment	597.0
Travel	895.0
	$ 2,534.5
Less: One-half claimed by spouse	1,267.2
Disallowed	$ 1,267.2

(d) Your income is decreased to allow for additional charitabl contributions to be taken into account from the Western Construction Co. as follows:

One-sixth of Western Construction Co. contributions	$ 119.1
Claimed in return	59.5
Additional allowance	$ 59.5

Computation of Income Tax—1944

Net income	$14,636.43	
Less: Surtax exemption	500.00	
Surtax net income	$14,136.43	
Surtax		$ 4,324.12
Net income	$14,636.43	
Less: Normal-tax exemption	500.00	
Balance subject to normal tax	$14,136.43	
Normal tax at 3 per cent		424.09
Income tax liability		$ 4,748.21
Income tax liability disclosed by return, Account #9001233		2,435.35
Deficiency in income tax		$ 2,312.86

Taxable Year Ended December 31, 1945

Adjustments to Net Income

Net income as disclosed by return	$18,078.43
Unallowable deductions and additional income:	
(a) Business income increased	11,623.82
(b) Long-term capital gain increased	300.22
(c) Personal expenses disallowed	150.00
Total	$30,152.47
Nontaxable income and additional deductions:	
(d) Interest income decreased	1,079.13
(e) Contributions increased	100.35
	$28,972.99

Explanation of Adjustments

(a) Your income is increased to reflect your corrected share of income of the Western Construction Co.

Such income is held to be community income and one-half thereof taxable to your spouse. Increase in your income is computed as follows:

One-sixth of corrected Western Construction Co. net income	$30,747.63
Reported in return	19,123.81
Increase	$11,623.82

(b) Your income is increased to reflect your corrected share of the Western Construction Co. long-term capital gain as follows:

One-sixth of Western Construction Co. long-term capital gain		$ 600.44
Reported in return		300.22
Increase		$ 300.22

(c) Your income is increased by the disallowance of the following unsubstantiated items which do not constitute necessary business expenses to you:

Car depreciation		$ 300.00
Less: One-half claimed by spouse		150.00
Claimed by taxpayer and disallowed		$ 150.00

(d) Your income is decreased by the elimination of so-called interest reported as having been received from your children as follows:

Roy W. Johnson	$719.42	
Evelyn L. Jorgens	719.42	
Eleanor J. Rector	719.42	$ 2,158.26
Less: Reported on return of spouse (one-half)		1,079.13
Reduction of income		$ 1,079.13

Since the transactions under which the purported liability of the children arose has been held to be ineffectual for income tax purposes the interest entries are likewise held to be without substance and do not represent taxable income.

(e) Your income is decreased to allow for additional charitable contributions to be taken into account from the Western Construction Co. as follows:

One-sixth of Western Construction Co. contributions	$ 200.70
Claimed in return	100.35
Additional allowance	$ 100.35

Computation of Tax

Your tax liability is correctly computed under the alternative tax method as follows:

1.	Net income	$28,972.99
2.	Minus: Excess of net long-term capital gain over net short-term capital loss	600.44
3.	Ordinary net income	$28,372.55
4.	Less: Surtax exemptions	500.00
5.	Balance (surtax net income)	$27,872.55
6.	Surtax on line 5	$11,900.98
7.	Ordinary net income	$28,372.55
8.	Less: Normal-tax exemption	500.00
9.	Balance subject to normal tax	$27,872.55
10.	Normal tax at 3 per cent	$ 836.18
11.	Partial tax (sum of lines 6 and 10)	$12,737.16
12.	Plus: 50% of line 2	300.22
13.	Alternative tax	$13,037.38
14.	Income tax liability	$13,037.38
15.	Liability disclosed by return Account #9001264	6,507.57
16.	Deficiency in income tax	$ 6,529.81

Received and Filed T.C.U.S. August 11, 1947.

[Title of Tax Court and Cause.]

Docket No. 15497

ANSWER

Now comes the Commissioner of Internal Revenue, by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed herein, admits, alleges and denies as follows:

1. Admits the allegations contained in paragragh 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits the allegations contained in paragraph 3 of the petition.

4(a). Admits that J. A. Johnson and the petitioner herein are husband and wife and as such constitute a martial community under the community property laws of the State of Washington. Admits that for the taxable years involved in this proceeding, petitioner and her husband have made separate returns purporting to divide their income equally on a community property basis for Federal tax purposes. Denies the remaining allegations of error and of fact contained in subparagraph (a) of paragraph 4 of the petition.

4(b) and (c). Denies the allegations of error and of fact contained in subparagraphs (b) and (c) of paragraph 4 of the petition.

5(a). Admits that petitioner is the wife of J. A. Johnson, one of three alleged general partners doing business under the name and style of Western Construction Company, who in 1942 and 1943 purported to enter into certain limited partnerships, and, among others, pretended to take into said business, as limited partners, petitioner's children, to wit: Roy W. Johnson, Evelyn Jorgens and Eleanor Rector. Denies each and every other material allegation contained in subparagraph (a) of paragraph 5 of the petition.

5(b) and (c). Denies each and every material allegation of error and of fact contained in subparagraphs (b) and (c) of paragraph 5 of the petition.

6. Admits that at approximately the same time as respondent issued the notice of deficiency in this proceeding determining the portion of the income of the Western Construction Company, which is includible for Federal tax purposes, in the return of this petitioner for the years involved, the Commissioner also issued a notice of deficiency to the Western Construction Company asserting against it deficiences in Federal income, declared value excess profits taxes and excess profits taxes on the basis that it is an association taxable as a corporation under the Federal revenue laws for the taxable years 1942 to 1945, inclusive. Alleges that the aggregate of the deficiencies so asserted against the said Western Construction Company for the years stated amounts to $728,832.16 instead of $594,735.72 as alleged by petitioner. Denies each and every other

material allegation contained in paragraph 6 of the petition.

7. Denies generally and specifically each and every material allegation contained in the petition, not hereinbefore specifically admitted, qualified or denied.

Wherefore, it is prayed that the petitioner's appeal be denied, and that the Commissioner's determination of deficiencies be approved.

/s/ CHARLES OLIPHANT, W.H.P.
Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:
B. H. NEBLETT,
Division Counsel.

WILFORD H. PAYNE,
Special Attorney,
Bureau of Internal Revenue.

Received and Filed T.C.U.S. October 1, 1947.

[Title of Tax Court and Cause.]

Docket No. 15497

AMENDMENT TO RESPONDENT'S ANSWER

Now comes the Commissioner of Internal Revenue, by his attorney Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, in accordance with Rule 17 of the Court's Rules of Practice and pursuant to oral motion on behalf of respondent which was granted by the Honorable Eugene Black, Judge of the Tax Court of the United States, at the hearing of this proceeding at Seattle, Washington, under date of May 26, 1948, by way of amendment to respondent's answer heretofore filed in the above-entitled cause and in order to conform his answer to the proof in the case, respectfully alleges and pleads, in the alternative, as follows:

8. In the event the Court should hold and determine that the limited partnership agreement with respect to Western Construction Company, which was executed February 24, 1942, and purporting to be effective as of January 2, 1942, should be recognized and given effect for Federal tax purposes as to the so-called limited partners, rather than taxing the entire partnership income to the general partners (and their spouses), then:

(a). The three equal general partners, J. A. Johnson, George J. Johnson and Albin Johnson are subject to tax with respect to one-half of the dis-

tributive partnership income (1/6 to each general partner) for the period January 2, 1942, to June 30, 1943 (the latter being the effective date of the second limited partnership agreement), instead of 45/105ths thereof (15/105ths as to each general partner) for the period during which the first limited partnership agreement was in effect, as reported in the individual income tax returns of said general partners and their spouses for the taxable years 1942 and 1943.

(b) Respondent hereby makes claim to any increase in the deficiency heretofore determined with respect to this petitioner which may result, as to each of the taxable years 1942 and 1943, by taxing each of the general partners (and his spouse) on 1/6 of the partnership income rather than 15/105ths thereof for the period January 2, 1942, to June 30, 1943.

(c). Effect may be given to respondent's alternative contention herein under a Rule 50 computation to be later submitted, in the event the decision of the Court with respect to the issues presented should require it, inasmuch as a Rule 50 computation will be necessary in any event in order to give effect to certain stipulations and concessions made by the parties at the hearing as to adjustments of income for the years 1942 and 1943.

Wherefore, it is prayed that petitioner's appeal

be denied and that respondent's determination be sustained.

/s/ CHARLES OLIPHANT, W.H.P.
Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:
B. H. NEBLETT,
Division Counsel.

WILFORD H. PAYNE,
Special Attorney,
Bureau of Internal Revenue.

Received and Filed T.C.U.S., June 15, 1948.

Served June 17, 1948.

The Tax Court of the United States,
Washington

Docket No. 15497

ELLEN M. JOHNSON,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Court as set forth in its Findings of Fact and Opinion promulgated March 22, 1950, the respondent herein filed a

computation on June 1, 1950, which was not contested by petitioner when called for hearing July 13, 1950, now therefore, it is

Ordered and Decided: that there are deficiencies in income tax for the calendar years 1943 and 1944 in the respective amounts of $3,348.71 and $357.89; and that there is an overpayment in income tax for the calendar year 1945 in the amount of $232.81, which amount was paid within two years before the mailing of the notice of deficiency.

[Seal] /s/ EUGENE BLACK,
Judge.

Entered July 14, 1950.

Served July 14, 1950.

In the United States Court of Appeals for the Ninth Circuit

T. C. Docket No. 15497

COMMISSIONER OF INTERNAL REVENUE,
Petitioner on Review,

vs.

ELLEN M. JOHNSON,
Respondent on Review.

PETITION FOR REVIEW

To the Honorable Judges of the United States Court of Appeals for the Ninth Circuit:

The Commissioner of Internal Revenue hereby

petitions the United States Court of Appeals for the Ninth Circuit to review the decision entered by The Tax Court of the United States on July 14, 1950, that there are deficiencies for the calendar years 1943 and 1944 in the respective amounts of $3,348.71 and $357.89, and that there is an overpayment for the calendar year 1945, in the amount of $232.81, in respect of the Federal income tax liability of Ellen M. Johnson, the above-named respondent on review. This petition for review is filed pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

The respondent on review, Ellen M. Johnson, is a citizen of the United States, residing at 1619 East 52nd Street, Seattle, Washington, and having an office address at 605 Arctic Building, Seattle, Washington. Respondent filed her Federal income tax returns for the years 1943, 1944 and 1945, the taxable years here involved, with the Collector of Internal Revenue for the District of Washington, whose office is located in Tacoma, Washington, and within the jurisdiction of the United States Court of Appeals for the Ninth Circuit where this review is sought.

Nature of Controversy

The respondent on review, Ellen M. Johnson, was, during the taxable years here involved, the wife of J. A. Johnson, one of the general partners of the Western Contruction Company. The Western Construction Company was created as a limited partnership under the laws of the State of Washington in 1942 and again in 1943. Its certificate of formation included J. A. Johnson, George Johnson and

Albin Johnson, three brothers, as its general partners and their several adult sons and daughters as limited partners. The partnership was engaged during the taxable years here involved in the general contracting business. Prior to its organization the business had been conducted by a predecessor corporation known as Western Construction Company, Inc. In his determination of deficiencies in income, declared value excess profits, and excess profits taxes against the partnership, the Commissioner determined that the Western Construction Company, under the so-called limited partnership agreements of February 24, 1942, and June 30, 1943, constituted an association taxable as a corporation as prescribed by Section 3797(a) (3) of the Internal Revenue Code and Section 29.3797-5 of Regulations 111, and that the so-called partnership or association, rather than its individual members, was taxable on the income earned by it during the calendar years 1942 to 1945, inclusive. In the alternative, it was determined by the Commissioner that if the Western Construction Company was recognizable as a valid partnership, for Federal income tax purposes, its income was taxable entirely to its three general partners, one of whom was the husband of the respondent on review herein, rather than being taxable on a distributable basis to said general partners and the ten alleged limited partners, children of the three general partners.

The Tax Court of the United States disagreed with the Commissioner's determination and held that the Western Construction Company was a bona

fide partnership composed of the three Johnson brothers and their several children as set out in the certificate of formation of the partnership and that it should be so recognized for tax purposes. Accordingly, in conformity with its opinion, the Tax Court entered its decision that there are no deficiencies in income tax, declared value excess profits tax and excess profits tax for the calendar years 1942, 1943, 1944 and 1945 in respect of the partnership and, as to the respondent on review herein, Ellen M. Johnson, and her husband, J. A. Johnson, refused to hold that their three children were not taxable on their shares of the partnership income and that such shares were taxable to their father, J. A. Johnson, and his wife, the respondent herein, on a community property basis.

/s/ THERON L. CAUDLE, C.A.R.
Assistant Attorney General.

/s/ CHARLES OLIPHANT, C.A.R.
Chief Counsel, Bureau of Internal Revenue Attorneys for Petitioner on Review.

Received and Filed T.C.U.S. October 9, 1950.

[Title of Tax Court and Cause.]

T. C. Docket No. 15497

STATEMENT OF POINTS

Comes Now the Commissioner of Internal Revenue, petitioner on review in the above-entitled

cause, by and through his attorneys, Theron L. Caudle, Assistant Attorney General, and Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, and hereby states that he intends to rely upon the following points in this proceeding:

The Tax Court of the United States erred:

1. In entering its decision that there are deficiencies in income tax for the calendar years 1943 and 1944, in the respective amounts of only $3,348.71 and $357.89, and that there is an overpayment in income tax for the calendar year 1945, in the amount of $232.81.

2. In failing and refusing to sustain the deficiencies in tax determined by the Commissioner on the basis that the taxpayer's husband, J. A. Johnson, was taxable upon one-third of the net income of the business conducted under the name of Western Construction Company, less the community portion of such income allocable to the taxpayer, Ellen M. Johnson, the wife of J. A. Johnson, as modified by stipulation and agreement of the parties in respect of items not now in controversy.

3. In holding and deciding that the Western Construction Company is a bona fide partnership composed of the three Johnson brothers and their several children as set out in the certificate of formation of the partnership and is recognized as such for tax purposes.

4. In failing and refusing to hold and decide that the Western Construction Company, during the tax-

able years involved, was a partnership consisting only of its three general partners, and that for Federal income tax purposes the income of such partnership was taxable to the general partners and their respective spouses and that the children of the general partners should not be recognized, for Federal income tax purposes, as bona fide partners in the business conducted by the said Western Construction Company.

5. In that its opinion and its decision that, for Federal income tax purposes, the Western Construction Company is a bona fide partnership composed of the three Johnson brothers and their several children as set out in the certificate of formation of the partnership is not supported by but is contrary to the evidence.

6. In that its opinion and its decision are not supported by but are contrary to the evidence.

7. In that its opinion and its decision are contrary to law and the Commissioner's regulations.

/s/ THERON L. CAUDLE, C.A.R.
Assistant Attorney General.

/s/ CHARLES OLIPHANT, C.A.R.
Special Attorney, Bureau of Internal Revenue, Attorneys for Petitioner on Review.

Statement of service attached.

Received and Filed T.C.U.S., December 21, 1950.

The Tax Court of the United States

Docket No. 15498

HULDAH JOHNSON,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

1947

Aug. 11—Petition received and filed. Taxpayer notified. Fee paid.

Aug. 12—Copy of petition served on General Counsel.

Oct. 1—Answer filed by General Counsel.

Oct. 1—Request for hearing in Seattle filed by General Counsel.

Oct. 10—Notice issued placing proceeding on Seattle, Wash. calendar. Service of answer and request made.

1948

Mar. 23—Hearing set 5/17/48, Seattle, Wash.

May 24, 25 & 26—Hearing had before Judge Black on merits, consolidated, cases to be kept open to receive claims for refund. Respondent to file amendment to answer by 6/20/48;

1948

reply by 7/10/48. Stipulation of facts filed. Briefs due 8/15/48; replies 9/15/48.

June 15—Amendment to respondent's answer filed by General Counsel.

July 12—Transcript of hearing May 24, 1948, filed.

July 12—Transcript of hearing May 25, 1948, filed.

July 12—Transcript of hearing May 26, 1948, filed.

Aug. 9—Motion for extension to 9/1/48 to file brief filed by taxpayer. 8/10/48 Granted.

Aug. 30—Motion for extension to 9/20/48 to file both briefs filed by taxpayer. Granted.

Aug. 30—Entry of appearance of Carbery O'Shea as counsel filed.

Sept. 8—Brief filed by General Counsel.

Sept. 16—Motion for extension to Oct. 5, 1948, to file brief filed by taxpayer. Granted.

Oct. 5—Brief filed by taxpayer. Copy served.

Nov. 1—Reply brief filed by taxpayer. Copy served.

Nov. 5—Reply brief filed by General Counsel.

1950

Mar. 22—Findings of fact and opinion rendered, Black, J. Decision will be entered under rule 50. 3/23/50. Copy served.

June 1—Respondent's computation filed.

1950

June 6—Hearing set July 13/50 on respondent's computation.

July 13—Hearing had before Judge Kern on settlement, uncontested, referred to J. Black.

July 14—Decision entered, Black, J., Div. 15.

Oct. 9—Petition for review by U. S. Court of Appeals, 9th Circuit, filed by General Counsel.

Nov. 2—Proof of service filed by General Counsel, (2).

Nov. 3—Motion for an extension to Jan. 5/51 to prepare and transmit the record filed by General Counsel.

Nov. 3—Order enlarging time to Jan. 5/51 to prepare and transmit the record entered.

Dec. 21—Statement re diminution of record filed by General Counsel.

Dec. 21—Statement of points with statement of service thereon filed by General Counsel.

[Titel of Tax Court and Cause.]

Docket No. 15498

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his Notice of Deficiency (Bur. Symbols, Seattle IT:90D; DM) dated May 29th, 1947, and as a basis for her proceeding alleges as follows:

1. The petitioner is a citizen and resident of the United States, residing at 1619 East 52nd, Seattle, Washington. The returns for the periods here involved were filed with the Collector of Internal Revenue for the Tacoma District of the State of Washington.

2. The notice of deficiency (a copy of which is attached hereto and marked Exhibit A) was mailed to the petitioner on May 29th, 1947.

3. The taxes in controversy are income taxes for the calendar years 1943, 1944 and 1945 and are in the total amount of $39,812.41.

4. The determination of tax set forth in the said notice of deficiency is based on the following errors:

(a) That the Commissioner erred in distributing the entire taxable income of the Western Construction Company, a limited partnership, to the three general partners, one of whom is the husband of the petitioner herein, instead of distributing the income according to the interests of the limited

partners as well as the general partners as per the returns of said limited and general partners. That the general partner, George Johnson and your petitioner are husband and wife, and as such constitute a marital community and under the community property laws of the State of Washington have made separate returns, equally dividing the community income in half, your petitioner therefore making a return of one-half of the community income.

(b) That the Commissioner erred in disallowing depreciation on personal auto of George Johnson, husband of the petitioner, travel and auto expenses, auto insurance and entertainment, to the petitioner.

(c) That the Commissioner erred in including as income to the general partners for 1945, the petitioners pro rata share of the profits of a contract known as "Boeing Alterations" not completed by the partnership until 1946. That said partnership is on a "completed contract basis" and the gross profit was included erroneously in 1945 for the partnership, amounting to a total of $7,571.12 which should not have been included in said 1945 income of said partnership.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) That prior to the taxable years above mentioned, the petitioner was the wife of George Johnson one of three general partners doing business under the name and style of Western Construction

Company who formed a limited partnership under and by vitrue of the laws of the State of Washington, taking into said limited partnership, among others, the petitioner's children, to wit: Lloyd W. Johnson, Bernice Wallin, Rachel Gustafson and Lorraine Ellingson. That said Lloyd W. Johnson, Bernice Wallin, Rachel Gustafson and Lorraine Ellingson, while a son and daughters of the petitioner were bona fide partners in said business conducted under the name of Western Construction Company, contributing additional capital and credit and/or personal services to said partnership. That said partnership was regularly and duly created as a limited partnership under the laws of the State of Washington, and that said partners, Lloyd W. Johnson, Bernice Wallin, Rachel Gustafson and Lorraine Ellingson assumed their proportionate full liability for losses, if any should occur, to the full amount of their capital investment, under the limited partnership laws of the State of Washington, and were entitled to their proportionate share of any profits. That the creation of said limited partnership was for a business purpose and that it was the intention of the general partners and of the limited partners to carry on said construction business as a partnership. That said limited partners at different times drew from said limited partnership different amounts from their share of the profits and used said amounts for their own personal use.

(b) That the Commissioner erred in disallowing depreciation on personal auto, travel and auto ex-

penses, auto insurance and entertainment. That the petitioner alleges that said automobile was used by her husband, George Johnson, in the business of Western Construction Company as an ordinary and necessary expense by the taxpayer in the activities of his business and that the agreement among the general partners provided that each general partner pay these expenses personally. Starting the first of 1945 this arrangement was changed so that the partnership paid the expenses of the cars, travel and entertainment but the partners should still provide their own cars; that the partnership owned no automobiles and that the cars of the general partners were the only cars available to carry on the business of the copartnership and that the particular cars upon which depreciation and expense were charged were used exclusively to carry on said copartnership business. That the entertainment of engineers and travel expense was also paid by each partner according to the agreement set forth above and as a regular and necessary expense of the husband of the petitioner in carrying on said copartnership business.

(c) That the Commissioner erred in including as income to the general partners for 1945, the petitioner's pro rata share of the profits of a contract known as "Boeing Alterations" not completed by the partnership until 1946. That said partnership is on a "completed contract basis" and the gross profit was included erroneously in 1945 for the partnership, amounting to a total of $7,571.12, which

should not have been included in said 1945 income of said partnership.

6. That the Commissioner, the respondent herein, did, at approximately the same time that he gave notice of deficiency, distributing the entire taxable income of the Western Construction Company to the three general partners, gave another notice of deficiency to said limited partnership as a whole alleging it to be an association and assessing said alleged association $594,735.72. That the total sum of said notices of deficiency covering the Commissioner's distributing the entire taxable income of the limited partnership to the three general partners, and the assessment against the alleged association is more than the entire income of said limited partnership during said taxable years of 1943, 1944 and 1945. That the respondent herein should be required to make an election as to which coure respondent wishes to pursue, to wit: to assess the entire taxable income of said limited partnership to the three general partners or to the limited partnership as an association—one or the other—prior to the hearing of this case upon its merits. That the Commissioner cannot in law or in equity at one and the same time distribute the income of the same entity to both the general partners and to an "association" composed of the general and limited partners.

Wherefore the petitioner prays that this Court may hear the proceeding and determine that the deficiency shown in the total amount of $39,812.41, as

due from the petitioner for the years 1943, 1944 and 1945, should be voided and eliminated and that the petitioner be found not to be indebted to the United States Government for income taxes for said years.

/s/ RALPH B. POTTS,
Attorney for Petitioner.

State of Washington,
County of King—ss.

Huldah Johnson, being first duly sworn, says that she is the petitioner above-named; that she has read the foregoing petition, or has had the same read to her, and is familiar with the statements contained therein, and that the statements contained therein are true, except those stated to be upon information and belief, and that those she believes to be true.

/s/ HULDAH JOHNSON.

Subscribed and sworn to before me this 30th day of July, 1947.

[Seal] /s/ LUCILLE POTTS,
Notary Public in and for the State of Washington,
Residing at Seattle.

EXHIBIT A

Treasury Department
Internal Revenue Service
Seattle 1, Washington

May 29, 1947.

Seattle Division,
305 A 1331 Third
Ave. Building,

IT:90D:DM

Mrs. Huldah Johnson,
605 Arctic Building,
Seattle 4, Washington.

Dear Mrs. Johnson:

You are advised that the determination of your income tax liability for the taxable years ended December 31, 1943, 1944, and 1945, discloses a deficiency of $39,812.41, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

With 90 days (not counting Saturday, Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the Tax Court of the United States, at is principal address, Washington 25, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are

requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Seattle 1, Washington for the attention of IT:90D:DM. The signing and filing of this form will expedite the closing of your returns by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

JOSEPH D. NUNAN, JR.,
Commissioner,

By /s/ L. E. HALLOWELL,
Acting Internal Revenue
Agent in Charge.

DM:mts

Enclosures:
Statement
Form of Waiver

T:90D:

STATEMENT

Mrs. Huldah Johnson
605 Aretic Building
Seattle, Washington

Tax liability for the taxable years ended December 31, 1943, December 31, 1944, and December 31, 1945.

Year		
1943	Income tax	$30,745.52
1944	Income tax	2,385.74
1945	Income tax	6,681.15
	Total	$39,812.41

In making this determination of your income tax liability, careful nsideration has been given to the reports of examination dated February 5, 1946, and September 16, 1946; to your protests dated April , 1946, January 14, 1947, and February 11, 1947; and to the statements made at the conferences held on June 12, 1946, and April 14, 947.

A copy of this letter and statement has been mailed to your representative, Mr. John H. Von Harten, 1411 Fourth Avenue Building, eattle 1, Washington, in accordance with the authority contained in e power of attorney executed by you.

In the computation of your net income for each year mentioned it held that you and your spouse are each taxable upon one-sixth of e net income of the business conducted under the name of Western nstruction Co. It is held that for income tax purposes your children, oyd W. Johnson, Bernice Wallin, Lorraine Ellingson and Rachel ustafson were not bona fide partners in the business conducted under e name of Western Construction Co. during the taxable years mened.

Taxable Year Ended December 31, 1942

Adjustments to Net Income

et income as disclosed by original return		$29,515.58
nallowable deductions and additional income:		
(a) Long-term capital gain	$ 1,845.74	
(b) Business income increased	35,699.63	
(c) Personal expenses disallowed	947.69	38,493.06
		$68,008.64
dditional deductions and nontaxable income:		
(d) Contributions increased		64.66
(e) Mathematical error in rental income		5.00
et income as adjusted		$67,938.98

Explanation of Adjustments

(a) Your income is increased to reflect your one-half share of th long-term capital gain of $3,691.47 upon the exchange of communit owned capital stock of the Western Construction Co., Inc.

(b) Your income is increased to reflect your corrected share c income of the Western Construction Co. Such income is held to b community income and one-half thereof taxable to your spouse. In crease in your income is computed as follows:

One-sixth of corrected Western Construction Co. net income	$69,974.3
Reported in return	34,274.7
Increase	$35,699.6

(c) Your income is increased by the disallowance of the followin unsubstantiated items which do not constitute necessary business ex penses to you:

Depreciation on personal auto	$ 338.3
Car operating expense	173.2
Car insurance	303.7
Entertainment of engineers, etc.	600.0
Travel expense	480.0
	$ 1,895.3
Less: One-half claimed by spouse	947.7
Balance claimed and disallowed	$ 947.6

(d) Your income is decreased to allow for additional charitab contributions to be taken into account from the Western Constructio Co., as follows:

One-sixth of Western Construction Co. contributions	$ 113.1
Claimed in return	48.4
Additional allowance	$ 64.6

(e) Your income is decreased by one-half of a $10.00 mathematica error made in computing net rental loss, line 6 of the return.

Computation of Tax

Your tax liability is correctly computed under the alternative ta method as follows:

1. Net income	$67,938.9
2. Minus: Excess of net long-term capital gain over net short-term capital loss	1,845.7
3. Ordinary net income	$66,093.2
4. Less: Personal exemption	600.0

6. Balance (surtax net income)		$65,493.24
8. Less: Earned income credit		1,396.01
9. Balance subject to normal tax		$64,097.23
0. Normal tax at 6 per cent	$ 3,845.83	
1. Surtax on item 6	33,630.34	
2. Partial tax		$37,476.17
3. Plus: 50% of line 2		922.86
4. Alternative tax		$38,399.03
5. Tax liability upon 1942 income		$38,399.03

Taxable Year Ended December 31, 1943

Adjustments to Net Income

	Income Tax Net Income	Victory Tax Net Income
s disclosed by return	$30,216.67	$31,414.35
nallowable deductions and additional income:		
(a) Business income	29,790.19	29,790.19
(b) Personal expenses disallowed	1,484.29	1,484.29
	$61,491.15	$62,688.83
dditional deductions and nontaxable income:		
(c) Contributions increased	111.61	—0—
come as adjusted	$61,379.54	$62,688.83

Explanation of Adjustments

(a) Your income is increased to reflect your corrected share of income of the Western Construction Co. Such income is held to be community income and one-half thereof taxable to your spouse. Increase your income is computed as follows:

ne-sixth of corrected Western Construction Co. net income	$62,443.30
eported in return	32,653.11
crease	$29,790.19

(b) Your income is increased by the disallowance of the followi unsubstantiated items which do not constitute business expenses you:

Depreciation on personal auto	$ 361
Car operating expense and travel	1,232
Car insurance	90
Entertainment	1,284
	$ 2,968
Less: One-half claimed by spouse	1,484
Claimed and disallowed	$ 1,484

(c) Your income is decreased to allow for additional charita contributions to be taken into account from the Western Constructi Co. as follows:

One-sixth of Western Construction Co. contributions	$ 208
Claimed in return	96
Additional allowance	$ 111

Computation of Income and Victory Tax

1.	Income tax net income		$61,379
2.	Less: Personal exemption		775
3.	Surtax net income		$60,604
4.	Less: Earned income credit		1,251
5.	Balance subject to normal tax		$59,352
6.	Normal tax at 6 per cent	$ 3,561.16	
7.	Surtax on item 3	30,257.13	
8.	Total income tax (item 6 plus item 7)		$33,818
10.	Balance of income tax		$33,818
11.	Victory tax net income	$62,688.83	
12.	Less: Specific exemption	624.00	
13.	Income subject to victory tax	$62,064.83	
14.	Victory tax before credit (5% of line 13)	$ 3,103.24	
15.	Less: Victory tax credit	500.00	
16.	Net victory tax		2,603

7. Net income tax and victory tax		$36,421.53
8. Income tax for 1942		$38,399.03
9. Amount of item 17 or 18 whichever is larger		$38,399.03
0. Forgiveness feature:		
(a) Amount of item 17 or 18 whichever is smaller	$36,421.53	
(b) Amount forgiven (¾ of (a))	27,316.15	
(c) Amount unforgiven		9,105.38
1. Total income and victory tax liability		$47,504.41
2. Income and victory tax liability disclosed by return, Account #6350169		16,758.89
3. Deficiency in income and victory tax		$30,745.52

Taxable Year Ended December 31, 1944

Adjustments to Net Income

Net income as disclosed by return		$10,065.73
Unallowable deductions and additional income:		
(a) Business income increased		4,275.25
(b) Long-term capital gain increased		17.43
(c) Personal expenses disallowed		1,171.32
		$15,529.73
Additional deductions and nontaxable income:		
(d) Contributions		59.58
Net income as adjusted		$15,470.15

Explanation of Adjustments

(a) Your income is increased to reflect your corrected share of income of the Western Construction Co. Such income is held to be community income and one-half thereof taxable to your spouse. Increase in your income is computed as follows:

One-sixth of corrected Western Construction Co. net income	$16,050.49
Reported in return	11,775.24
Increase	$ 4,275.25

(b) Your income is increased to reflect your corrected share of the Western Construction Co. long-term capital gain as follows:

One-sixth of Western Construction Co. long-term capital gain	$ 34.85
Reported in return	17.42
Increase	$ 17.43

(c) Your income is increased by the disallowance of the followi unsubstantiated items which do not constitute necessary business e penses to you:

Depreciation on personal auto	$ 361.
Car operating expense	628.
Travel	730.
Entertainment	622.
	$ 2,342.
Less: One-half claimed by spouse	1,171.
Claimed and disallowed	$ 1,171.

(d) Your income is decreased to allow for additional charitab contributions to be taken into account from the Western Constructi Co. as follows:

One-sixth of Western Construction Co. contributions	$ 119.
Claimed in return	59.
Additional allowance	$ 59.

Computation of Income Tax—1944

1.	Net income	$15,470.15	
2.	Less: Surtax exemption	500.00	
3.	Surtax net income	$14,970.15	
4.	Surtax		$ 4,715.
5.	Net income	$15,470.15	
6.	Less: Normal-tax exemption	500.00	
7.	Balance subject to normal tax	$14,970.15	
8.	Normal tax at 3 per cent		449.
9.	Total income tax (item 4 plus item 8)		$ 5,165.
11.	Income tax liability		$ 5,165.
12.	Income tax liability disclosed by return, Account #9001235		2,779.
13.	Deficiency in income tax		$ 2,385.

Taxable Year Ended December 31, 1945

Adjustments to Net Income

Net income as disclosed by return		$19,279.55
Unallowable deductions and additional income:		
(a) Business income increased	$11,623.81	
(b) Long-term capital gain increased	300.22	
(c) Personal expenses disallowed	180.71	
Total		$31,384.29
Nontaxable income and additional deductions:		
(d) Interest income decreased	1,076.65	
(e) Contributions increased	100.34	
Net income as adjusted		$30,207.30

Explanation of Adjustments

(a) Your income is increased to reflect your corrected share of income of the Western Construction Co. Such income is held to be community income and one-half thereof taxable to your spouse. Increase in your income is computed as follows:

One-sixth of corrected Western Construction Co. net income	$30,747.62
Reported in return	19,123.81
Increase	$11,623.81

(b) Your income is increased to reflect your corrected share of the Western Construction Co. long-term capital gain as follows:

One-sixth of Western Construction Co. long-term capital gain	$ 600.44
Reported in return	300.22
Increase	$ 300.22

(c) Your income is increased by the disallowance of the following unsubstantiated items which do not constitute necessary business expenses to you:

Car depreciation	$ 361.41
Claimed by spouse and disallowed	180.70
Claimed by taxpayer and disallowed	$ 180.71

(d) Your income is decreased by the elimination of so-called interest reported as having been received from your children as follows:

Boyd W. Johnson	$776.65	
Bernice Wallin	776.65	
Lorraine Ellingson	300.00	
Rachel Gustafson	300.00	$ 2,153.30
Less: One-half reported on return of spouse		1,076.65
Reduction of income		$ 1,076.65

Since the transactions under which the purported liability of th children arose has been held to be ineffectual for income tax purpose the interest entries are likewise held to be without substance and d not represent taxable income.

(e) Your income is decreased to allow for additional charitab contributions to be taken into account from the Western Constructio Co. as follows:

One-sixth of Western Construction Co. contributions	$ 200.6
Claimed in return	100.3
Additional allowance	$ 100.3

Computation of Tax

Your tax liability is correctly computed under the alternative ta method as follows:

1.	Net income	$30,207.3
2.	Minus: Excess of net long-term capital gain over net short-term capital loss	600.4
3.	Ordinary net income	$29,606.8
4.	Less: Surtax exemptions	500.0
5.	Balance (surtax net income)	$29,106.8
6.	Surtax on line 5	$12,666.2
7.	Ordinary net income	$29,606.8
8.	Less: Normal-tax exemption	500.0
9.	Balance subject to normal tax	$29,106.8
10.	Normal tax at 3 per cent	$ 873.2
11.	Partial tax (sum of lines 6 and 10)	$13,539.4
12.	Plus: 50% of line 2	300.2
13.	Alternative tax	$13,839.6
14.	Correct tax liability	$13,839.6
15.	Disclosed by return Acct. #9001585	7,158.5
16.	Deficiency	$ 6,681.1

Received and Filed T.C.U.S. August 11, 1947.

[Title of Tax Court and Cause.]

Docket No. 15498

ANSWER

Now comes the Commissioner of Internal Revenue, by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed herein, admits, alleges and denies as follows:

1. Admits the allegations contained in paragragh 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits the allegations contained in paragraph 3 of the petition.

4(a). Admits that George Johnson and the petitioner herein are husband and wife and as such constitute a marital community under the community property laws of the State of Washington. Admits that for the taxable years involved in this proceeding, petitioner and her husband have made separate returns purporting to divide their income equally on a community property basis for Federal tax purposes. Denies the remaining allegations of error and of fact contained in subparagraph (a) of paragraph 4 of the petition.

4(b) and (c). Denies the allegations of error and of fact contained in subparagraphs (b) and (c) of paragraph 4 of the petition.

5(a). Admits that petitioner is the wife of George Johnson, one of three alleged general partners doing business under the name and style of Western Construction Company, who in 1942 and 1943, purported to enter into certain limited partnerships and, among others, pretended to take into said business, as limited partners, petitioner's children, to wit: Lloyd W. Johnson, Bernice Wallin, Rachel Gustafson, and Lorraine Ellingson. Denies each and every other material allegation contained in subparagraph (a) of paragraph 5 of the petition.

5(b) and (c). Denies each and every material allegation of error and of fact contained in subparagraphs (b) and (c) of paragraph 5 of the petition.

6. Admits that at approximately the same time as respondent issued the notice of deficiency in this proceeding determining the portion of the income of the Western Construction Company, which is includible, for Federal tax purposes, in the return of this petitioner for the years involved, the Commissioner also issued a notice of deficiency to the Western Construction Company asserting against it deficiencies in Federal income, declared value excess profits taxes and excess profits taxes on the basis that it is an association taxable as a corporation under the Federal revenue laws for the taxable years 1942 to 1945 inclusive. Alleges that the aggregate of the deficiencies so asserted against the said Western Construction Company, for the years stated, amounts to $728,832.16 instead of $594,735.72, as alleged by petitioner. Denies each and

every other material allegation contained in paragraph 6 of the petition.

7. Denies generally and specifically each and every material allegation contained in the petition, not hereinbefore specifically admitted, qualified or denied.

Wherefore, it is prayed that the petitioner's appeal be denied, and that the Commissioner's determination of deficiencies be approved.

/s/ CHARLES OLIPHANT, W.H.P.
Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel,

WILFORD H. PAYNE,
Special Attorney,
Bureau of Internal Revenue.

Received and Filed T.C.U.S., October 1, 1947.

[Title of Tax Court and Cause.]

Docket No. 15498

AMENDMENT TO RESPONDENT'S ANSWER

Now, comes the Commissioner of Internal Revenue, by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, in accord-

ance with Rule 17 of the Court's Rules of Practice and pursuant to oral motion on behalf of respondent which was granted by the Honorable Eugene Black, Judge of the Tax Court of the United States, at the hearing of this proceeding at Seattle, Washington, under date of May 26, 1948, by way of amendment to respondent's answer heretofore filed in the above-entitled cause and in order to conform his answer to the proof in the case, respectfully alleges and pleads, in the alternative, as follows:

8. In the event the Court should hold and determine that the limited partnership agreement with respect to Western Construction Company, which was executed February 24, 1942, and purporting to be effective as of January 2, 1942, should be recognized and given effect for Federal tax purposes as to the so-called limited partners, rather than taxing the entire partnership income to the general partners (and their spouses), then:

(a). The three equal general partners, J. A. Johnson, George J. Johnson and Albin Johnson are subject to tax with respect to one-half of the distributive partnership income (1/6 to each general partner) for the period January 2, 1942, to June 30, 1943 (the latter being the effective date of the second limited partnership agreement), instead of 45/105ths thereof (15/105ths as to each general partner) for the period during which the first limited partnership agreement was in effect, as reported in the individual income tax returns of said general partners and their spouses for the taxable years 1942 and 1943.

(b). Respondent hereby makes claim to any increase in the deficiency heretofore determined with respect to this petitioner which may result, as to each of the taxable years 1942 and 1943, by taxing each of the general partners (and his spouse) on 1/6 of the partnership income rather than 15/105ths thereof for the period January 2, 1942 to June 30, 1943.

(c). Effect may be given to respondent's alternative contention herein under a Rule 50 computation to be later submitted, in the event the decision of the Court with respect to the issues presented should require it, inasmuch as a Rule 50 computation will be necessary in any event in order to give effect to certain stipulations and concessions made by the parties at the hearing as to adjustments of income for the years 1942 and 1943.

Wherefore, it is prayed that petitioner's appeal be denied and that respondent's determination be sustained.

/s/ CHARLES OLIPHANT, W.H.P.
Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel.

WILFORD H. PAYNE,
Special Attorney,
Bureau of Internal Revenue.

Received and Filed T.C.U.S., June 15, 1948.

Served June 17, 1948.

The Tax Court of the United States, Washington

Docket No. 15498

HULDAH JOHNSON,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the determination of the Court as set forth in its Findings of Fact and Opinion promulgated March 22, 1950, the respondent herein filed a computation on June 1, 1950, which was not contested by petitioner when called for Hearing July 13, 1950, now therefore, it is

Ordered and Decided: That there are deficiencies in income tax for the calendar years 1943 and 1944, in the respective amounts of $3,650.23 and $339.85; and that there is an overpayment in income tax for the calendar year 1945, in the amount of $228.79, which amount was paid within two years before the mailing of the notice of deficiency.

[Seal] /s/ EUGENE BLACK,
Judge.

Entered July 14, 1950.

Served July 14, 1950.

In the United States Court of Appeals
for the Ninth Circuit
Docket No. 15498

COMMISSIONER OF INTERNAL REVENUE,
Petitioner on Review,

vs.

HULDAH JOHNSON,
Respondent on Review,

PETITION FOR REVIEW

To the Honorable Judges of the United States Court of Appeals for the Ninth Circuit:

The Commissioner of Internal Revenue hereby petitions the United States Court of Appeals for the Ninth Circuit to review the decision entered by The Tax Court of the United States on July 14, 1950, that there are deficiencies for the calendar years 1943 and 1944 in the respective amounts of $3,650.23 and $339.85, and that there is an overpayment for the calendar year 1945 in the amount of $228.79, in respect of the Federal income tax liability of Huldah Johnson, the above-named respondent on review. This petition for review is filed pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

The respondent on review, Huldah Johnson, is a citizen of the United States, residing at 1619 East 52nd Street, Seattle, Washington, and having an office address at 605 Arctic Building, Seattle, Washington. Respondent filed her Federal income tax returns for the years 1943, 1944 and 1945, the tax-

able years here involved, with the Collector of internal Revenue for the District of Washington, whose office is located in Tacoma, Washington, and within the jurisdiction of the United States Court of Appeals for the Ninth Circuit where this review is sought.

Nature of Controversy

The respondent on review, Huldah Johnson, was, during the taxable yeras here involved, the wife of George Johnson, one of the general partners of the Western Construction Company. The Western Construction Company was created as a limited partnership under the laws of the State of Washington in 1942 and again in 1943. Its certificate of formation included J. A. Johnson, George Johnson and Albin Johnson, three brothers, as its general partners and their several adult sons and daughters as limited partners. The partnership was engaged during the taxable years here involved in the general contracting business. Prior to its organization the business had been conducted by a predecessor corporation known as Western Construction Company, Inc. In his determination of deficiencies in income, declared value excess profits, and excess profits taxes against the partnership, the Commissioner determined that the Western Construction Company, under the so-called limited partnership agreements of February 24, 1942 and June 30, 1943, constituted an association taxable as a corporation as prescribed by Section 3797(a)(3) of the Internal Revenue Code and Section 29.3797-5 of Regulations 111, and that the so-called partnership or

association, rather than its individual members. was taxable on the income earned by it during the calendar years 1942 to 1945, inclusive. In the alternative, it was determined by the Commissioner that if the Western Construction Company was recognizable as a valid partnership, for Federal income tax purposes, its income was taxable entirely to its three general partners, one of whom was the husband of the respondent on review herein, rather than being taxable on a distributable basis to said general partners and the ten alleged limited partners, children of the three general partners.

The tax Court of the United States disagreed with the Commissioner's determination and held that the Western Construction Company was a bona fide partnership composed of the three Johnson brothers and their several children as set out in the certificate of formation of the partnership and that it should be so recognized for tax purposes. Accordingly, in conformity with its opinion, the Tax Court entered its decision that there are not deficiencies in income tax, declared value excess profits tax, and excess profits tax for the calendar years 1942, 1943, 1944 and 1945 in respect of the partnership and, as to the respondent on review herein, Huldah Johnson, and her husband George Johnson, refused to hold that their four children were not taxable on their shares of the partnership income and that such shares were taxable shares of the partnership income and that such to their father,

George Johnson, and his wife, the respondent herein, on a community property basis.

/s/ THERON L. CAUDLE, CWR
Assistant Attorney General.

/s/ CHARLES OLIPHANT, CWR
Chief Counsel,
Bureau of Internal Revenue, Attorneys for Petitioner on Review.

Received and Filed T. C. U. S., October 9, 1950.

[Court of Appeals and Cause.]

T. C. Docket No. 15498

STATEMENT OF POINTS

Comes Now the Commissioner of Internal Revenue, petitioner on review in the above-entitled cause, by and through his attorneys, Theron L. Caudle, Assistant Attorney General, and Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, and hereby states that he intends to rely upon the following points in this proceeding:

The Tax Court of the United States erred:

1. In entering its decision that there are deficiencies in income tax for the calendar years 1943 and 1944 in the respective amounts of only $3,650.23 and $339.85, and that there is an overpayment in income tax for the calendar year 1945 in the amount of $228.79.

2. In failing and refusing to sustain the deficiencies in tax determined by the Commissioner on the basis that the taxpayer's husband, George J. Johnson, was taxable upon one-third of the net income of the business conducted under the name of Western Construction Company, less the community portion of such income allocable to the taxpayer, Huldah Johnson, the wife of George J. Johnson, as modified by stipulation and agreement of the parties in respect of items not now in controversy.

3. In holding and deciding that the Western Construction Company is a bona fide partnership composed of the three Johnson brothers and their several children as set out in the certificate of formation of the partnership and is recognized as such for tax purposes.

4. In failing and refusing to hold and decide that the Western Construction Company, during the taxable years involved, was a partnership consisting only of its three general partners, and that for Federal income tax purposes the income of such partnership was taxable to the general partners and their respective spouses and that the children of the general partners should not be recognized, for Federal income tax purposes, as bona fide partners in the business conducted by the said Western Construction Company.

5. In that its opinion and its decision that, for Federal income tax purposes, the Western Con-

struction Company is a bona fide partnership composed of the three Johnson brothers and their several children as set out in the certificate of formation of the partnership is not supported by but is contrary to the evidence.

6. In that its opinion and its decision are not supported by but are contrary to the evidence.

7. In that its opinion and its decision are contrary to law and the Commissioner's regulations.

/s/ THERON L. CAUDLE, CWR
Assistant Attorney General.

/s/ CHARLES OLIPHANT, CWR
Chief Counsel Bureau of Internal Revenue, Attorneys for Petitioner on Review.

Statement of service attached.

Received and Filed T. C. U. S., December 21, 1950.

The Tax Court of the United States

Docket No. 15499

GEORGE J. JOHNSON,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

1947

Aug. 11—Petition received and filed. Taxpayer notified. Fee paid.

Aug. 12—Copy of petition served on General Counsel.

Oct. 1—Answer filed by General Counsel.

Oct. 1—Request for hearing in Seattle, Wash., filed by General Counsel.

Oct. 10—Notice issued placing proceeding on Seattle, Wash. calendar. Service of answer and request made.

1948

Mar. 23—Hearing set 5/17/48, Seattle, Wash.

May 24,
25 & 26—Hearing had before Judge Black on merits. Consolidated. Cases to be kept open to receive claim for refund. Respondent to file amendment to answer by

1948

6/20/48; reply due 7/10/48. Stipulation of facts filed. Briefs due 8/15/48; replies 9/15/48.

June 15—Amendment to respondent's answer filed by General Counsel.

July 12—Transcript of hearing May 24, 1948 filed.

July 12—Transcript of hearing May 25, 1948 filed.

July 12—Transcript of hearing May 26, 1948 filed.

Aug. 9—Motion for extension to 9/1/48 to file brief filed by taxpayer. 8/10/48 Granted.

Aug. 30—Motion for extension to 9/20/48 to file both briefs filed by taxpayer 8/31/48 Granted.

Aug. 30—Entry of appearance of Carbery O'Shea as counsel filed.

Sept. 8—Brief filed by General Counsel.

Sept. 16—Motion for extension to Oct. 5, 1948 to file brief filed by taxpayer. Granted.

Oct. 5—Brief filed by taxpayer. Copy served.

Nov. 1—Reply brief filed by taxpayer. Copy served.

Nov. 5—Reply brief filed by General Counsel.

1950

Mar. 22—Findings of fact and opinion rendered, Black, J. Decision will be entered under rule 50. 3/23/50. Copy served.

1950

June 1—Respondent's computation filed.

June 6—Hearing set July 13/50 on respondent's computation.

July 13—Hearing had before Judge Kern on settlement, uncontested, referred to J. Black.

July 14—Decision entered, Black, J., Div. 15.

Oct. 9—Petition for review by U. S. Court of Appeals, 9th Circuit, filed by General Counsel.

Nov. 2—Proof of service filed by General Counsel. (2)

Nov. 2—Affidavit of service of petition for review filed.

Nov. 3—Motion for extension to Jan. 5, 1951 to prepare and transmit the record filed by General Counsel.

Nov. 3—Order enlarging time to Jan. 5, 1951 to prepare and transmit the record entered.

Dec. 21—Statement re diminution of record filed by General Counsel.

Dec 21—Statement of points with statement of service thereon filed by General Counsel.

[Title of Court and Cause.]

Docket No. 15499

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his Notice of Deficiency (Bur. Symbols, Seattle IT:90D:DM) dated May 29, 1947, and as a basis for his proceeding alleges as follows:

1. The petitioner is a citizen and resident of the United States, residing at 4560-55th Avenue Northeast, Seattle, Washington. The returns for the periods here involved were filed with the Collector of Internal Revenue for the Tacoma District of the State of Washington.

2. The notice of deficiency (a copy of which is attached hereto and marked Exhibit A) was mailed to the petitioner on May 29, 1947.

3. The taxes in controversy are income taxes for the calendar years 1943, 1944 and 1945 and are in the total amount of $38,828.50.

4. The determination of tax set forth in the said notice of deficiency is based on the following errors:

(a) That the Commissioner erred in distributing the entire taxable income of the Western Construction Company, a limited partnership, to the three general partners of which the petitioner herein is one, instead of distributing the income

according to the interests of the limited partners as well as the general partners as per the returns of said limited and general partners.

(b) That the Commissioner erred in disallowing depreciation on personal auto, travel and auto expenses, auto insurance and entertainment, to the petitioner.

(c) That the Commissioner erred in including as income to the general partners for 1945, the petitioner's pro rata share of the profits of a contract known as "Boeing Alterations" not completed by the partnership until 1946. That said partnership is on a "completed contract basis" and the gross profit was included erroneously in 1945 for the partnership, amounting to a total of $7,571.12, which should not have been included in said 1945 income of said partnership.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) That prior to the taxable years above mentioned the petitioner as one of three general partners doing business under the name and style of Western Construction Company, formed a limited partnership under and by virtue of the laws of the State of Washington, taking into said limited partnership, among others, the petitioner's children, to-wit: Lloyd W. Johnson, Bernice Wallin, Rachel Gustafson and Lorraine Ellingson. That said Lloyd W. Johnson, Bernice Wallin, Rachel Gustafson and Lorraine Ellingson, while a son and daughters of the petitioner were bona fide partners in said busi-

ness conducted under the name of Western Construction Company, contributing additional capital and credit and/or personal services to said partnership. That said partnership was regularly and duly created as a limited partnership under the laws of the State of Washington and that said partners, Lloyd W. Johnson, Bernice Wallin, Rachel Gustafson and Lorraine Ellingson assumed their proportionate full liability for losses, if any should occur, to the full amount of their capital investment under the limited partnership laws of the State of Washington, and were entitled to their proportionate share of any profits. That the creation of said limited partnership was for a business purpose and that it was the intention of the general partners and of the limited partners to carry on said construction business as a partnership. That said limited partners at different times drew from said limited partnership different amounts from their share of the profits and used said amounts for their own personal use.

(b) That the Commissioner erred in disallowing depreciation on personal auto, travel and auto expenses, auto insurance and entertainment. That the petitioner alleges that said automobile was used in the business of Western Construction Company as an ordinary and necessary expense by the taxpayer in the activities of his business and that the agreement among the general partners provided that each general partner pay these expenses personally. Starting the first of 1945 this arrangement was changed so that the partnership paid the ex-

penses of the cars, travel and entertainment but the partners should still provide their own cars; that the partnership owned no automobiles and that the cars of the general partners were the only cars available to carry on the business of the copartnership and that the particular cars upon which depreciation and expense were charged were used exclusively to carry on said copartnership business. That the entertainment of engineers and travel expense was also paid by each partner according to the agreement set forth above and as a regular and necessary expense of the petitioner in carrying on said copartnership business.

(c) That the Commissioner erred in including as income to the general partners for 1945, the petitioner's pro rata share of the profits of a contract known as "Boeing Alterations" not completed by the partnership until 1946. That said partnership is on a "completed contract basis" and the gross profits was included erroneously in 1945 for the partnership, amounting to a total of $7,571.12. which should not have been included in said 1945 income of said partnership.

6. That the Commissioner, the respondent herein, did, at approximately the same time that he gave notice of deficiency, distributing the entire taxable income of the Western Construction Company to the three general partners, gave another notice of deficiency to said limited partnership as a whole alleging it to be an association and assessing said alleged association $594,735.72. That the total

sum of said notices of deficiency, covering the Commissioner's distributing the entire taxable income of the limited partnership to the three general partners, and the assessment against the alleged association is more than the entire income of said limited partnership during said taxable years of 1943, 1944 and 1945. That the respondent herein should be required to make an election as to which course respondent wishes to pursue, to-wit: to assess the entire taxable income of said limited partnership to the three general partners or to the limited partnership as an association—one or the other—prior to the hearing of this case upon its merits. That the Commissioner cannot in law or in equity at one and the same time distribute the income of the same entity to both the general partners and to an "association" composed of the general and limited partners.

Wherefore the petitioner prays that this Court may hear the proceeding and determine that the deficiency shown in the total amount of $38,828.50 as due from the petitioner for the years 1943, 1944 and 1945 should be voided and eliminated and that the petitioner be found not to be indebted to the United States Government for income taxes for said years.

/s/ RALPH B. POTTS,
Attorney for Petitioner.

State of Washington
County of King—ss.

George J. Johnson, being duly sworn, says that he is the petitioner above-named; that he has read the foregoing petition, or has had the same read to him, and is familiar with the statements contained therein, and that the statements contained therein are true, except those stated to be upon information and belief, and that those he believes to be true.

/s/ GEORGE J. JOHNSON.

Subscribed and sworn to before me this 30th day of July, 1947.

[Seal] /s/ LUCILLE POTTS,
Notary Public in and for the State of Washington, residing at Seattle.

EXHIBIT A

Treasury Department
Internal Revenue Service
Seattle 1, Washington

May 29, 1947

Seattle Division
305 A 1331 Third Avenue

IT:90D:DM

Mr. George J. Johnson
605 Arctic Building
Seattle 4, Washington

Dear Mr. Johnson:

You are advised that the determination of your income tax liability for the taxable years ended December 31, 1943, 1944 and 1945 discloses a deficiency of $38,828.50, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Saturday, Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington 25, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward

it to the Internal Revenue Agent in Charge, Seattle 1, Washington for the attention of IT:90D:DM. The signing and filing of this form will expedite the closing of your returns by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,
JOSEPH D. NUNAN, JR.,
Commissioner,

By /s/ L. E. HALLOWELL,
Acting Internal Revenue
Agent in Charge.

DM:mts

Enclosures:
Statement
Form of Waiver

IT:90D:DM

STATEMENT

Mr. George J. Johnson
605 Arctic Building
Seattle, Washington

Tax liability for the taxable years ended December 31, 1943, December 31, 1944, and December 31, 1945.

Year		Deficiency
1943	Income tax	$29,872.23
1944	Income tax	2,320.75
1945	Income tax	6,635.52
	Total	$38,828.50

In making this determination of your income tax liability, carefu consideration has been given to the reports of examination dated Feb ruary 5, 1946, and September 26, 1946; to your protests dated Apri 17, 1946, January 14, 1947, and February 11, 1947; and to the state ments made at the conferences held on June 12, 1946, and April 14 1947.

A copy of this letter and statement has been mailed to your repre sentative, Mr. John H. Von Harten, 1411 Fourth Avenue Building Seattle 1, Washington, in accordance with the authority contained i the power of attorney executed by you.

In the computation of your net income for each year mentioned i is held that you and your spouse are each taxable upon one-sixth of th net income of the business conducted under the name of Western Con struction Co. It is held that for income tax purposes your children Lloyd W. Johnson, Bernice Wallin, Lorraine Ellingson and Rache Gustafson were not bona fide partners in the business conducted unde the name of Western Construction Co. during the taxable years men tioned.

Taxable Year Ended December 31, 1942

Adjustments to Net Income

Net income as disclosed by original return		$29,515.5
Unallowable deductions and additional income:		
(a) Long-term capital gain	$ 1,845.74	
(b) Business income increased	35,699.63	
(c) Personal expenses disallowed	947.69	38,493.0
		$68,008.6
Additional deductions and nontaxable income:		
(d) Contributions increased		64.6
(e) Mathematical error in rental income		5.0
Net income as adjusted		$67,938.9

Explanation of Adjustments

(a) Your income is increased to reflect your one-half share of the ng-term capital gain of $3,691.47 upon the exchange of community wned capital stock of the Western Construction Co., Inc.

(b) Your income is increased to reflect your corrected share of in- me of the Western Construction Co. Such income is held to be com- unity income and one-half thereof taxable to your spouse. Increase your income is computed as follows:

ne-sixth of corrected Western Construction Co. net income	$69,974.35
eported in return	34,274.72
ncrease	$35,699.63

(c) Your income is increased by the disallowance of the following nsubstantiated items which do not constitute necessary business ex- enses to you:

epreciation on personal auto	$ 338.39
ar operating expense	173.22
ar insurance	303.78
ntertainment of engineers, etc.	600.00
avel expense	480.00
	$ 1,895.39
ss: One-half claimed by spouse	947.70
lance claimed and disallowed	$ 947.69

(d) Your income is decreased to allow for additional charitable ntributions to be taken into account from the Western Construction ., as follows:

ne-sixth of Western Construction Co. contributions	$ 113.16
aimed in return	48.49
dditional allowance	$ 64.66

(e) Your income is decreased by one-half of a $10.00 mathematical ror made in computing net rental loss, line 6 of the return.

Computation of Tax

Your tax liability is correctly computed under the alternative tax thod as follows:

Net income		$67,938.98
Minus: Excess of net long-term capital gain over net short-term capital loss		1,845.74
Ordinary net income		$66,093.24
Less: Personal exemption	$ 600.00	
Credit for dependents	350.00	950.00
Balance (surtax net income)		$65,143.24
Less: Earned income credit		1,396.01

9. Balance subject to normal tax		$63,747.2
10. Normal tax at 6 per cent	$ 3,824.83	
11. Surtax on item 6	33,388.84	
12. Partial tax		$37,213.6
13. Plus: 50% of line 2		922.8
14. Alternative tax		$38,136.5
15. Tax liability upon 1942 income		$38,136.5

Taxable Year Ended December 31, 1943

Adjustments to Net Income

	Income Tax Net Income	Victory Ta Net Incom
As disclosed by return	$30,216.67	$31,414.3
Unallowable deductions and additional income:		
(a) Business income	29,790.19	29,790.1
(b) Personal expenses disallowed	1,484.29	1,484.2
	$61,491.15	$62,688.8
Additional deductions and nontaxable income:		
(c) Contributions increased	111.61	—0—
Income as adjusted	$61,379.54	$62,688.8

Explanation of Adjustments

(a) Your income is increased to reflect your corrected share income of the Western Construction Co. Such income is held to community income and one-half thereof taxable to your spouse. I crease in your income is computed as follows:

One-sixth of corrected Western Construction Co. net income	$62,443.
Reported in return	32,653.
Increase	$29,790.

(b) Your income is increased by the disallowance of the followi unsubstantiated items which do not constitute necessary business e penses to you:

Depreciation on personal auto	$ 361.
Car operating expense and travel	1,232.
Car insurance	90.
Entertainment	1,284.
	$ 2,968.
Less: One-half claimed by spouse	1,484.
Claimed and disallowed	$ 1,484.

(c) Your income is decreased to allow for additional charitable ontributions to be taken into account from the Western Construction o. as follows:

ne-sixth of Western Construction Co. contributions	$ 208.33
laimed in return	96.72
dditional allowance	$ 111.61

Computation of Income and Victory Tax

1.	Income tax net income		$61,379.54
2.	Less: Personal exemption	$ 425.00	
	Credit for dependents	350.00	775.00
3.	Surtax net income		$60,604.54
4.	Less: Earned income credit		1,251.81
5.	Balance subject to normal tax		$59,352.73
6.	Normal tax at 6 per cent	$ 3,561.16	
7.	Surtax on item 3	30,257.13	
8.	Total income tax (item 6 plus item 7)		$33,818.29
9.	Balance of income tax		$33,818.29
10.	Victory tax net income	$62,688.83	
11.	Less: Specific exemption	624.00	
12.	Income subject to victory tax	$62,064.83	
13.	Victory tax before credit (5% of line 13)	$ 3,103.24	
14.	Less: Victory tax credit	600.00	
15.	Net victory tax		2,503.24
16.	Net income tax and victory tax		$36,321.53
17.	Income tax for 1942		$38,136.54
18.	Amount of item 17 or 18 whichever is larger		$38,136.54
19.	Forgiveness feature:		
	(a) Amount of item 17 or 18 whichever is smaller	$36,321.53	
	(b) Amount forgiven (¾ of (a))	27,241.15	
	(c) Amount unforgiven		9,080.38
20.	Total income and victory tax liability		$47,216.92
21.	Income and victory tax liability disclosed by return, Account #6350170		17,344.69
22.	Deficiency in income and victory tax		$29,872.23

Taxable Year Ended December 31, 1944

Adjustments to Net Income

Net income as disclosed by return	$20,065.7
Unallowable deductions and additional income:	
(a) Business income increased	4,272.8
(b) Long-term capital gain increased	17.5
(c) Personal expenses disallowed	1,117.9
Total	$25,529.7
Additional deductions and nontaxable income:	
(d) Contributions	50.0
Net income as adjusted	$25,479.7

Explanation of Adjustments

(a) Your income is increased to reflect your increased share of income of the Western Construction Co. Such income is held to be community income and one-half thereof taxable to your spouse. Increase in your income is computed as follows:

One-sixth of increased Western Construction Co. net income	$26,050.9
Reported in return	21,778.1
Increase	$ 4,272.8

(b) Your income is increased to reflect your increased share of the Western Construction Co. long-term capital gain as follows:

One-sixth of Western Construction Co. long-term capital gain	$ 34.9
Reported in return	17.4
Increase	$ 17.5

(c) Your income is increased by the disallowance of the following unsubstantiated items which do not constitute necessary business expenses to you:

Depreciation on personal cars	$ 302.-
Car operating expenses	225.-
Travel	750.-
Entertainment	90.-
	$ 1,367.-
Less: One-half claimed by spouse	249.1
Claimed and disallowed	$ 1,117.9

(d) Your income is decreased to allow for additional charitable contributions to be taken into income from the Western Construction Co., as follows:

One-sixth of Western Construction Co. contributions	$ 100.-
Claimed in return	50.-
Additional allowance	$ 50

Computation of Income Tax—1944

1. Net income	$15,470.15	
2. Less: Surtax exemption	1,000.00	
3. Surtax net income	$14,470.15	
4. Surtax		$ 4,480.98
5. Net income	$15,470.15	
6. Less: Normal-tax exemption	500.00	
7. Balance subject to normal tax	$14,970.15	
8. Normal tax at 3 per cent		449.10
9. Total income tax (item 4 plus item 8)		$ 4,930.08
10. Income tax liability		$ 4,930.08
11. Income tax liability disclosed by return, Account #9002364		2,609.33
12. Deficiency in income tax		$ 2,320.75

Taxable Year Ended December 31, 1945

Adjustments to Net Income

Net income as disclosed by return		$19,279.55
Disallowable deductions and additional income:		
(a) Business income increased		11,623.81
(b) Long-term capital gain increased		300.22
(c) Personal expenses disallowed		180.71
Total		$31,384.29
Nontaxable income and additional deductions:		
(d) Interest income decreased		1,076.65
(e) Contributions increased		100.34
Net income as adjusted		$30,207.30

Explanation of Adjustments

(a) Your income is increased to reflect your corrected share o income of the Western Construction Co. Such income is held to b community income and one-half thereof taxable to your spouse. In crease in your income is computed as follows:

One-sixth of corrected Western Construction Co. net income	$30,747.6
Reported in return	19,123.8
Increase	$11,623.8

(b) Your income is increased to reflect your corrected share of th Western Construction Co. long-term capital gain as follows:

One-sixth of Western Construction Co. long-term capital gain	$ 600.4
Reported in return	300.2
Increase	$ 300.2

(c) Your income is increased by the disallowance of the followin unsubstantiated items which do not constitute necessary business ex penses to you:

Car depreciation	$ 361.4
Claimed by spouse and disallowed	180.7
Claimed by taxpayer and disallowed	$ 180.7

(d) Your income is decreased by the elimination of so-called in terest reported as having been received from your children as follows

Lloyd W. Johnson	$776.65	
Bernice Wallin	776.65	
Lorraine Ellingson	300.00	
Rachel Gustafson	300.00	$ 2,153.3
Less: One-half reported on return of spouse		1,076.6
Reduction of income		$ 1,076.6

Since the transactions under which the purported liability of th children arose has been held to be ineffectual for income tax purpose the interest entries are likewise held to be without substance and d not represent taxable income.

(e) Your income is decreased to allow for additional charitab contributions to be taken into account from the Western Constructio Co. as follows:

One-sixth of Western Construction Co. contributions	$ 200.6
Claimed in return	100.3
Additional allowance	$ 100.3

Computation of Tax

Your tax liability is correctly computed under the alternative tax method as follows:

1.	Net income	$30,207.30
2.	Minus: Excess of net long-term capital gain over net short-term capital loss	600.44
3.	Ordinary net income	$29,606.86
4.	Less: Surtax exemptions	1,000.00
5.	Balance (surtax net income)	$28,606.86
6.	Surtax on line 5	$12,356.25
7.	Ordinary net income	$29,606.86
8.	Less: Normal-tax exemption	500.00
9.	Balance subject to normal tax	$29,106.86
10.	Normal tax at 3 per cent	$ 873.21
11.	Partial tax (sum of lines 6 and 10)	$13,229.46
12.	Plus: 50% of line 2	300.22
13.	Alternative tax	$13,529.68
14.	Total tax liability	$13,529.68
15.	Disclosed by return, Account #3011863	6,894.16
16.	Deficiency in income tax	$ 6,635.52

Received and Filed T.C.U.S. August 11, 1947.

[Title of Tax Court and Cause.]

Docket No. 15499

ANSWER

Now comes the Commissioner of Internal Revenue, by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed herein, admits, alleges and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits the allegations contained in paragraph 3 of the petition.

4(a), (b) and (c). Denies that in determining the deficiencies asserted in the statutory notice the respondent committed any errors, and specifically denies the allegations of error set forth in subparagraphs (a), (b) and (c) of paragraph 4 of the petition.

5(a). Admits that petitioner, as one of three alleged general partners, doing business under the name and style of the Western Construction Company, in 1942 and 1943 purported to enter into certain limited partnerships and, among others, pretended to take into said business, as limited partners, petitioner's children, to wit: Lloyd W. Johnson, Bernice Wallin, Rachel Gustafson and Lorraine Ellingson. Denies each and every other material allegation

contained in subparagraph (a) of paragraph 5 of the petition.

5(b) and (c). Denies each and every allegation of error and of fact contained in subparagraphs (b) and (c) of paragraph 5 of the petition.

6. Admits that at approximately the same time as respondent issued the notice of deficiency in this proceeding determining the portion of the income of the Western Construction Company which is includible, for Federal tax purposes, in the return of this petitioner for the years involved, the Commissioner also issued a notice of deficiency to the Western Construction Company asserting against it deficiencies in Federal income, declared value excess profits taxes and excess profits taxes on the basis that it is an association taxable as a corporation under the Federal revenue laws for the taxable years 1942 to 1945 inclusive. Alleges that the aggregate of the deficiencies so asserted against the said Western Construction Company, for the years stated, amounts to $728,832.16 instead of $594,735.72 as alleged by petitioner. Denies each and every other material allegation contained in paragraph 6 of the petition.

7. Denies generally and specifically each and every material allegation contained in the petition, not hereinbefore specifically admitted, qualified or denied.

Wherefore, it is prayed that the petitioner's ap-

peal be denied, and that the Commissioner's determination of deficiencies be approved.

/s/ CHARLES OLIPHANT, WHP
Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:
B. H. NEBLETT,
Division Counsel.

WILFORD H. PAYNE,
Special Attorney,
Bureau of Internal Revenue.

Received and filed T.C.U.S. October 1, 1947.

[Title of Tax Court and Cause.]

Docket No. 15499

AMENDMENT TO RESPONDENT'S ANSWER

Now comes the Commissioner of Internal Revenue, by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, in accordance with Rule 17 of the Court's Rules of Practice and pursuant to oral motion on behalf of respondent which was granted by the Honorable Eugene Black, Judge of the Tax Court of the United States, at the hearing of his proceeding at Seattle, Washington, under date of May 26, 1948, by way of amendment to respondent's answer heretofore filed in the above-entitled cause and in order to conform his answer

to the proof in the case, respectfully alleges and pleads, in the alternative, as follows:

8. In the event the Court should hold and determine that the limited partnership agreement with respect to Western Construction Company, which was executed February 24, 1942, and purporting to be effective as of January 2, 1942, should be recognized and given effect for Federal tax purposes as to the so-called limited partners, rather than taxing the entire partnership income to the general partners (and their spouses), then:

(a). The three equal general partners, J. A. Johnson, George J. Johnson, and Albin Johnson, are subject to tax with respect to one-half of the distributive partnership income (1/6 to each general partner) for the period January 2, 1942, to June 30, 1943 (the latter being the effective date of the second limited partnership agreement), instead of 45/105ths thereof (15/105ths as to each general partner) for the period during which the first limited partnership agreement was in effect, as reported in the individual income tax returns of said general partners and their spouses for the taxable years 1942 and 1943.

(b). Respondent hereby makes claim to any increase in the deficiency heretofore determined with respect to this petitioner which may result, as to each of the taxable years 1942 and 1943, by taxing each of the general partners (and his spouse) on 1/6 of the partnership income rather than 15/105ths

thereof for the period January 2, 1942 to June 30, 1943.

(c). Effect may be given to respondent's alternative contention herein under a Rule 50 computation to be later submitted, in the event the decision of the Court with respect to the issues presented should require it, inasmuch as a Rule 50 computation will be necessary in any event in order to give effect to certain stipulations and concessions made by the parties at the hearing as to adjustments of income for the years 1942 and 1943.

Wherefore, it is prayed that petitioner's appeal be denied and that respondent's determination be sustained.

/s/ CHARLES OLIPHANT, WHP
Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel.

WILFORD H. PAYNE,
Special Attorney,
Bureau of Internal Revenue.

Received and Filed T.C.U.S. June 15, 1948.

Served June 17, 1948.

The Tax Court of the United States
Washington

Docket No. 15499

GEORGE J. JOHNSON,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the determination of the Court as set forth in its Findings of Fact and Opinion promulgated March 22, 1950, the respondent herein filed a computation on June 1, 1950, which was not contested by petitioner when called for hearing July 13, 1950, now therefore, it is

Ordered and Decided: that there are deficiencies in income tax for the calendar years 1943 and 1944 in the respective amounts of $2,815.43 and $322.38; and that there is an overpayment in income tax for the calendar year of 1945 in the amount of $216.54, which amount was paid within two years before the mailing of the notice of deficiency.

[Seal]: /s/ EUGENE BLACK,
Judge.

Entered July 14, 1950.

Served July 14, 1950.

In the United States Court of Appeals
For the Ninth Circuit

T. C. Docket No. 15499

COMMISSIONER OF INTERNAL REVENUE,
Petitioner on Review,

vs.

GEORGE J. JOHNSON,
Respondent on Review.

PETITION FOR REVIEW

To the Honorable Judges of the United States Court of Appeals for the Ninth Circuit:

The Commissioner of Internal Revenue hereby petitions the United States Court of Appeals for the Ninth Circuit to review the decision entered by The Tax Court of the United States on July 14, 1950, that there are deficiencies for the calendar years 1943 and 1944 in the respective amounts of $2,815.43 and $322.38, and that there is an overpayment for the calendar year 1945 in the amount of $216.54, in respect of the Federal income tax liability of George J. Johnson, the above-named respondent on review. This petition for review is filed pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

The respondent on review, George J. Johnson, is a citizen of the United States, residing at 4560 55th Avenue Northeast, Seattle, Washington, and

having an office address at 605 Arctic Building, Seattle, Washington. Respondent filed his Federal income tax returns for the years 1943, 1944 and 1945, the taxable years here involved, with the Collector of Internal Revenue for the District of Washington, whose office is located in Tacoma, Washington, and within the jurisdiction of the United States Court of Appeals for the Ninth Circuit where this review is sought.

Nature of Controversy

The respondent on review, George J. Johnson, was, during the taxable years here involved, one of the general partners of the Western Construction Company. The Western Construction Company was created as a limited partnership under the laws of the State of Washington in 1942 and again in 1943. Its certificate of formation included J. A. Johnson, George Johnson and Albin Johnson, three brothers, as its general partners and their several adult sons and daughters as limited partners. The partnership was engaged during the taxable years here involved in the general contracting business. Prior to its organization the business had been conducted by a predecessor corporation known as Western Construction Company, Inc. In his determination of deficiencies in income, declared value excess profits, and excess profits taxes against the partnership, the Commissioner determined that the Western Construction Company, under the so-called limited partnership agreements of February 24,

1942, and June 30, 1943, constituted an association taxable as a corporation as prescribed by Section 3797(a)(3) of the Internal Revenue Code and Section 29.3797-5 of Regulations 111, and that the so-called partnership or association, rather than its individual members, was taxable on the income earned by it during the calendar years 1942 to 1945, inclusive. In the alternative, it was determined by the Commissioner that if the Western Construction Company was recognizable as a valid partnership, for Federal income tax purposes, its income was taxable entirely to its three general partners, one of whom was the respondent on review herein, rather than being taxable on a distributable basis to said general partners and the ten alleged limited partners, children of the three general partners.

The Tax Court of the United States disagreed with the Commissioner's determination and held that the Western Construction Company was a bona fide partnership composed of the three Johnson brothers and their several children as set out in the certificate of formation of the partnership and that it should be so recognized for tax purposes. Accordingly, in conformity with its opinion, the Tax Court entered its decision that there are no deficiencies in income tax, declared value excess profits tax, and excess profits tax for the calendar years 1942, 1943, 1944 and 1945 in respect of the partnership and, as to the respondent on review herein, George J. Johnson, refused to hold that his four children were not taxable on their shares

of the partnership income and that such shares were taxable to their father, George Johnson, [George J. Johnson] the respondent herein.

/s/ THERON L. CAUDLE,
Assistant Attorney General.

/s/ CHARLES OLIPHANT,
Chief Counsel, Bureau of Internal Revenue, Attorneys for Petitioner on Review.

Received and Filed T.C.U.S. October 9, 1950.

[Title of Court of Appeals and Cause.]

T. C. Docket No. 15499

STATEMENT OF POINTS

Comes Now the Commissioner of Internal Revenue, petitioner on review in the above-entitled cause, by and through his attorneys, Theron L. Caudle, Assistant Attorney General, and Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, and hereby states that he intends to rely upon the following points in this proceeding:

The Tax Court of the United States erred:

1. In entering its decision that there are deficiencies in income tax for the calendar years 1943 and 1944 in the respective amounts of only $2,815.43 and $322.38, and that there is an overpayment in income tax for the calendar year 1945 in the amount of $216.54.

2. In failing and refusing to sustain the deficiencies in tax determined by the Commissioner on the basis that the taxpayer was taxable upon one-third of the net income of the business conducted under the name of Western Construction Company, less the community portion of such income allocable to taxpayer's wife, as modified by stipulation and agreement of the parties in respect of items not now in controversy.

3. In holding and deciding that the Western Construction Company is a bona fide partnership composed of the three Johnson brothers and their several children as set out in the certificate of formation of the partnership and is recognized as such for tax purposes.

4. In failing and refusing to hold and decide that the Western Construction Company, during the taxable years involved, was a partnership consisting only of its three general partners, and that for Federal income tax purposes the income of such partnership was taxable to the general partners and their respective spouses and that the children of the general partners should not be recognized, for Federal income tax purposes, as bona fide partners in the business conducted by the said Western Construction Company.

5. In that its opinion and its decision that, for Federal income tax purposes, the Western Construction Company is a bona fide partnership composed of the three Johnson brothers and their several children as set out in the certificate of forma-

tion of the partnership is not supported by but is contrary to the evidence.

6. In that its opinion and its decision are not supported by but are contrary to the evidence.

7. In that its opinion and its decision are contrary to law and the Commissioner's regulations.

/s/ THERON L. CAUDLE, CAR
Assistant Attorney General.

/s/ CHARLES OLIPHANT, CAR
Chief Counsel, Bureau of Internal Revenue, Attorneys for Petitioner on Review.

Statement of service attached.

Received and Filed T.C.U.S. December 21, 1950.

The Tax Court of the United States

Docket No. 15500

J. A. JOHNSON,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

1947

Aug. 11—Petition received and filed. Taxpayer notified. Fee paid.

1947

Aug. 12—Copy of petition served on General Counsel.

Oct. 1—Answer filed by General Counsel.

Oct. 1—Request for hearing in Seattle filed by General Counsel.

Oct. 10—Notice issued placing proceeding on Seattle, Wash., calendar.
Service of answer and request made.

1948

Mar. 23—Hearing set 5/17/48, Seattle, Wash.

May 24, 25 and 26—Hearing had before Judge Black on merits. Consolidated. Oral motion to keep cases open to receive claim for refund. Granted. Respondent to file amendment to answer by 6/20/48; reply due 7/10/48. Stipulation of facts filed. Briefs due 8/15/48; replies 9/15/48.

June 15—Amendment to respondent's answer filed by General Counsel.

July 12—Transcript of hearing May 24, 1948, filed.

July 12—Transcript of hearing May 25, 1948, filed.

July 12—Transcript of hearing May 26, 1948, filed.

Aug. 9—Motion for extension to 9/1/48 to file brief filed by taxpayer.
8/10/48 Granted.

1948

Aug. 30—Motion for extension to 9/20/48 to file both briefs filed by taxpayer. 8/31/48 granted.

Aug. 30—Entry of appearance of Carbery O'Shea as counsel filed.

Sept. 8—Brief filed by General Counsel.

Sept. 16—Motion for extension to Oct. 5, 1948, to file brief filed by taxpayer. Granted.

Oct. 5—Brief filed by taxpayer. Copy served.

Nov. 1—Reply brief filed by taxpayer. Copy served.

Nov. 5—Reply brief filed by General Counsel.

1950

Mar. 22—Findings of fact and opinion rendered, Black, J. Decision will be entered under rule 50. 3/23/50 Copy served.

June 1—Respondent's computation filed.

June 6—Hearing set July 13/50 on respondent's computation.

July 13—Hearing had before Judge Kern on settlement, uncontested, referred to J. Black.

July 14—Decision entered, Black, J., Div. 15.

Oct. 9—Petition for review by U. S. Court of Appeals, 9th Circuit, filed by General Counsel.

Nov. 2—Proof of service filed by General Counsel. (2)

1950

Nov. 2—Affidavit of service of petition for review filed.

Nov. 3—Motion for extension of time to Jan. 5, 1951 to prepare and transmit the record filed by General Counsel.

Nov. 3—Order enlarging time to Jan. 5, 1951, to prepare and transmit the record entered.

Dec. 21—Statement re diminution of record filed by General Counsel.

Dec. 21—Statement of points with statement of service thereon filed by General Counsel.

[Title of Tax Court and Cause.]

Docket No. 15500

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his Notice of Deficiency (Bur. Symbols, Seattle IT:90D:DM) dated May 29th, 1947, and as a basis for his proceeding alleges as follows:

1. The petitioner is a citizen and resident of the United States, residing at 1619 East 52nd, Seattle, Washington. The returns for the periods here involved were filed with the Collector of Internal Revenue for the Tacoma District of the State of Washington.

2. The notice of deficiency (a copy of which is attached hereto and marked Exhibit A) was mailed to the petitioner on May 29th, 1947.

3. The taxes in controversy are income taxes for the calendar years 1943, 1944 and 1945 and are in the total amount of $37,903.24.

4. The determination of tax set forth in the said notice of deficiency is based on the following errors:

(a) That the Commissioner erred in distributing the entire taxable income of the Western Construction Company, a limited partnership, to the three general partners of which the petitioner herein is one, instead of distributing the income according to the interests of the limited partners as well as the general partners as per the returns of said limited and general partners.

(b) That the Commissioner erred in disallowing depreciation on personal auto, travel and auto expenses, auto insurance and entertainment, to the petitioner.

(c) That the Commissioner erred in including as income to the general partners for 1945 the petitioner's pro rata share of the profits of a contract known as "Boeing Alterations" not completed by the partnership until 1946. That said partnership is on a "completed contract basis" and the gross profit was included erroneously in 1945 for the partnership, amounting to a total of $7,571.12, which should not have been included in said 1945 income of said partnership.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) That prior to the taxable years above mentioned the petitioner as one of three general partners doing business under the name and style of Western Construction Company, formed a limited partnership under and by virtue of the laws of the State of Washington, taking into said limited partnership, among others, the petitioner's children, to wit: Roy W. Johnson, Evelyn Jorgens and Eleanor Rector. That said Roy W. Johnson, Evelyn Jorgens and Eleanor Rector, while a son and daughters of the petitioner were bona fide partners in said business conducted under the name of Western Construction Company, contributing additional capital and credit and/or personal services to said partnership. That said partnership was regularly and duly created as a limited partnership under the laws of the State of Washington and that said partners, Roy W. Johnson, Evelyn Jorgens and Eleanor Rector assumed their proportionate full liability for losses, if any should occur, to the full amount of their capital investment under the limited partnership laws of the State of Washington, and were entitled to their proportionate share of any profits. That the creation of said limited partnership was for a business purpose and that it was the intention of the general partners and of the limited partners to carry on said construction business as a partnership. That said limited partners at different times drew from said limited partnership different

amounts from their share of the profits and used said amounts for their own personal use.

(b) That the Commissioner erred in disallowing depreciation on personal auto, travel and auto expenses, auto insurance and entertainment. That the petitioner alleges that said automobile was used in the business of Western Construction Company as an ordinary and necessary expense by the taxpayer in the activities of his business and that the agreement among the general partners provided that each general partner pay these expenses personally. Starting the first of 1945 this arrangement was changed so that the partnership paid the expenses of the cars, travel and entertainment but the partners should still provide their own cars; that the partnership owned no automobiles and that the cars of the general partners were the only cars available to carry on the business of the copartnership and that the particular cars upon which depreciation and expense were charged were used exclusively to carry on said copartnership business. That the entertainment of engineers and travel expense was also paid by each partner according to the agreement set forth above and as a regular and necessary expense of the petitioner in carrying on said copartnership business.

(c) That the Commissioner erred in including as income to the general partners for 1945 the petitioner's pro rata share of the profits of a contract known as "Boeing Alterations" not completed

by the partnership until 1946. That said partnership is on a "completed contract" basis and the gross profit was included erroneously in 1945 for the partnership amounting to a total of $7,571.12 which should not have been included in said 1945 income of said partnership.

6. That the Commissioner of Internal Revenue, the respondent herein, did, at aproximately the same time that he gave notice of deficiency, distributing the entire taxable income of the Western Construction Company to the three general partners, gave another notice of deficiency to said limited partnership as a whole alleging it to be an association and assessing said alleged association $594,735.72. That the total sum of said notices of deficiency, covering the Commissioner's distributing the entire taxable income of the limited partnership to the three general partners, and the assessment against the alleged association is more than the entire income of said limited partnership during said taxable years of 1943, 1944 and 1945. That the respondent herein should be required to make an election as to which course respondent wishes to pursue, to wit: to assess the entire taxable income of said limited partnership to the three general partners or to the limited partnership as an association—one or the other—prior to the hearing of this case upon its merits. That the Commission cannot in law or in equity at one and the same time distribute the income of the same entity to both the general partners and to an "association" composed of the general and limited partners.

Wherefore the petitioner prays that this Court

may hear the proceeding and determine that the deficiency shown in the total amount of $37,903.24 as due from the petitioner for the years 1943, 1944 and 1945 should be voided and eliminated and that the petitioner be found not to be indebted to the United States Government for income taxes for said years.

/s/ RALPH B. POTTS,
Attorney for Petitioner.

State of Washington,
County of King—ss.

J. A. Johnson, being first duly sworn, says that he is the petitioner above named; that he has read the foregoing petition, or has had the same read to him, and is familiar with the statements contained therein, and that the statements contained therein are true, except those stated to be upon information and belief, and that those he believes to be true.

/s/ J. A. JOHNSON.

Subscribed and sworn to before me this 30th day of July, 1947.

[Seal] /s/ LUCILLE POTTS,
Notary Public in and for the State of Washington, residing at Seattle.

EXHIBIT A

Treasury Department
Internal Revenue Service,
Seattle 1, Washington

Seattle Division
305 A 1331 Third Avenue Bldg.,
IT:90D:DM

Mr. J. A. Johnson,
605 Arctic Building,
Seattle 4, Washington.

Dear Mr. Johnson:

You are hereby advised that the determination of your income tax liability for the taxable years ended December 31, 1943, 1944 and 1945 discloses a deficiency of $37,903.24, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the Tax Court of the United States, at its principal address, Washington 25, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Seattle, 1, Washington for the attention of IT:90D:DM.

The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

JOSEPH D. NUNAN, JR.,
Commissioner,

By /s/ L. E. HALLOWELL,
Acting Internal Revenue
Agent in Charge.

DM:mts
Enclosures:
Statement
Form of Waiver

IT:90D:DM

STATEMENT

Mr. J. A. Johnson
605 Arctic Building
Seattle, Washington

Tax liability for the taxable years ended December 31, 1943, December 31, 1944, and December 31, 1945.

Year		Deficiency
1943	Income tax	$29,111.03
1944	Income tax	2,262.40
1945	Income tax	6,529.81
		$37,903.24

In making this determination of your income tax liability, careful consideration has been given to the reports of examination dated February 5, 1946, and September 16, 1946; to your protests dated April 17, 1946, January 14, 1947, and February 11, 1947; and to the statements made at the conferences held on June 12, 1946, and April 14, 1947.

A copy of this letter and statement has been mailed to your representative, Mr. John H. Von Harten, 1411 Fourth Avenue Building, Seattle 1, Washington, in accordance with the authority contained in the power of attorney executed by you.

In the computation of your net income for each year mentioned, it is held that you and your spouse are each taxable upon one-sixth of the net income of the business conducted under the name of Western Construction Co. It is held that for income tax purposes your children (Roy W. Johnson, Evelyn L. Jorgens and Eleanor J. Rector) were not bona fide partners in the business conducted under the name of Western Construction Co. during the taxable years mentioned.

Taxable Year Ended December 31, 1942

Adjustments to Net Income

Net income as disclosed by original return		$27,457.3
Unallowable deductions and additional income:		
(a) Long-term capital gain	$ 1,845.74	
(b) Business income increased	35,699.63	
(c) Personal expenses disallowed	1,038.95	38,584.3
		$66,041.7
Additional deductions and nontaxable income:		
(d) Contributions increased		64.4
Net income as adjusted		$65,977.0

Explanation of Adjustments

(a) Your income is increased to reflect your one-half share of the ong-term capital gain of $3,691.47 upon the exchange of community)wned capital stock of Western Construction Co. Inc.

(b) Your income is increased to reflect your corrected share of ncome of the Western Construction Co.

Such income is held to be community income and one-half thereof axable to your spouse. Increase in your income is computed as fol- ows:

)ne-sixth of corrected Western Construction Co. net income	$69,974.35
Reported in return	34,274.72
ncrease	$35,699.63

(c) Your income is increased by the disallowance of the following nsubstantiated items which do not constitute necessary business ex- enses to you:

)epreciation on personal auto	$	300.00
'ar operating expense		494.64
'ar insurance		203.27
'ntertainment of engineers, etc.		600.00
'ravel expense		480.00
	$	2,077.91
ess one-half claimed by spouse		1,038.96
alance claimed by taxpayer disallowed	$	1,038.95

(d) Your income is decreased to allow for additional charitable ontributions to be taken into account from the Western Construction 'ompany as follows:

ne-sixth of Western Construction Co. contributions	$	113.16
laimed in return		48.49
dditional allowance	$	64.66

Computation of Tax

Your tax liability is correctly computed under the alternative tax ethod as follows:

1.	Net income		$65,977.04
2.	Minus: Excess of net long-term capital gain over net short-term capital loss		1,945.74
3.	Ordinary net income		$64,131.30
4.	Less: Personal exemption	$ 600.00	
5.	Credit for dependents	87.50	687.50
6.	Balance (surtax net income)		63,443.80
8.	Less: Earned income credit		1,396.01
9.	Balance subject to normal tax		63,047.79

10. Normal tax at 6 per cent	$ 3,722.87	
11. Surtax on item 6	32,216.22	
12. Partial tax		35,939.0
13. Plus: 50% of line 2		922.8
14. Alternative tax		$36,861.9
15. Tax liability upon 1942 income		36,861.9

Taxable Year Ended December 31, 1943

Adjustments to Net Income

	Income Tax Net Income	Victory Tax Net Income
Net income as disclosed by return	$29,960.22	$31,321.4
Unallowable deductions and additional income:		
(a) Business income increased	29,790.26	29,790.2
(b) Personal expenses disallowed	1,478.60	1,478.6
Total	$61,228.88	
Additional deductions and nontaxable income:		
(c) Contributions	111.62	
Income as adjusted	$61,117.26	$62,590.3

Explanation of Adjustments

(a) Your income is increased to reflect your corrected share o income of the Western Construction Co. Such income is held to b community income and one-half thereof taxable to your spouse. In crease in your income is computed as follows:

One-sixth of corrected Western Construction Co. net income	$62,443.3
Reported in return	32,653.1
Increase	$29,790.2

(b) Your income is increased by the disallowance of the followin unsubstantiated items which do not constitute necessary business ex penses to you:

Depreciation on personal auto	$ 300.0
Travel and auto expenses	1,232.0
Auto insurance	140.9
Entertainment	1,284.2
	$ 2,957.2
Less: One-half claimed by spouse	1,478.6
Balance disallowed	$ 1,478.6

(c) Your income is decreased to allow for additional charitable ontributions to be taken into account from the Western Construction o. as follows:

ne-sixth of Western Construction Co. contributions		$ 208.34
laimed in return		96.72
dditional allowance		$ 111.62
1. Income tax net income		$61,117.26
2. Less: Personal exemption		600.00
3. Surtax net income		$60,517.26
4. Less: Earned income credit		1,251.81
5. Balance subject to normal tax		$59,265.45
6. Normal tax at 6 per cent	$ 3,555.93	
7. Surtax on item 3	30,196.91	
8. Total income tax (item 6 plus item 7)		33,752.84
9. Balance of income tax		$33,752.84
0. Victory tax net income	$62,590.32	
1. Less: Specific exemption	624.00	
2. Income subject to victory tax	$61,966.32	
3. Victory tax before credit (5% of line 13)	$ 3,098.32	
4. Less: Victory tax credit	500.00	
5. Net victory tax		2,598.32
6. Net income tax and victory tax		$36,351.16
7. Income tax for 1942		$36,861.96
8. Amount of item 17 or 18 whichever is larger		$36,861.96
9. Forgiveness feature:		
(a) Amount of item 17 or 18 whichever is smaller	$36,351.16	
(b) Amount forgiven (¾ of (a))	27,263.39	
(c) Amount unforgiven		9,087.79
1. Total income and victory tax liability		45,949.75
2. Income and victory tax liability disclosed by return, Account #6350168		16,838.72
3. Deficiency in income and victory tax		$29,111.03

Taxable Year Ended December 31, 1944

Adjustments to Net Income

Net income as disclosed by return	$ 9,136.11
Unallowable deduction and additional income:	
(a) Business income increased	4,275.24
(b) Long-term capital gain increased	17.42
(c) Personal expenses disallowed	1,267.25
Total	$14,696.02
Additional deductions and nontaxable income:	
(d) Contributions	59.59
Income as adjusted	$14,636.43

Explanation of Adjustments

(a) Your income is increased to reflect your corrected share of income of the Western Construction Co. Such income is held to be community income and one-half thereof taxable to your spouse. Increase in your income is computed as follows:

One-sixth of corrected Western Construction Co. net income	$16,050.49
Reported in return	11,775.25
Increase	$ 4,275.24

(b) Your income is increased to reflect your corrected share of the Western Construction Co. long-term capital gain as follows:

One-sixth of Western Construction Co. long term capital gain	$ 34.84
Reported in return	17.42
Increase	$ 17.42

(c) Your income is increased by the disallowance of the following unsubstantiated items which do not constitute necessary business expenses to you:

Depreciation on personal auto	$ 300.00
Car operating expense	742.50
Entertainment	597.00
Travel	895.00
	$ 2,534.50
Less: One-half claimed by spouse	1,267.25
Disallowed	$ 1,267.25

(d) Your income is decreased to allow for additional charitable contributions to be taken into account from the Western Construction Co. as follows:

One-sixth of Western Construction Co. contributions	$ 119.17
Claimed in return	59.58
Additional allowance	$ 59.59

Computation of Income Tax—1944

Net income	$14,636.43	
Less: Surtax exemption	1,000.00	
Surtax net income	$13,636.43	
Surtax		$ 4,103.66
Net income	$14,636.43	
Less: Normal-tax exemption	500.00	
	$14,136.43	
Normal tax at 3 per cent		424.09
Income tax liability		$ 4,527.75
Income tax liability disclosed by return, Account #9002366		2,265.35
Deficiency in income tax		$ 2,262.40

Taxable Year Ended December 31, 1945

Adjustments to Net Income

Net income as disclosed by return		$18,078.43
Unallowable deductions and additional income		
(a) Business income increased		11,623.82
(b) Long term capital gain increased		300.22
(c) Personal expenses disallowed		150.00
		$30,152.47
Nontaxable income and additional deductions:		
(d) Interest income decreased		1,079.13
(e) Contributions increased		100.35
Net income as adjusted		$28,972.99

Explanation of Adjustments

(a) Your income is increased to reflect your corrected share of income of the Western Construction Co. Such income is held to be community income and one-half thereof taxable to your spouse. Increase in your income is computed as follows:

One-sixth of corrected Western Construction Co. net income	$30,747.63
Reported in return	19,123.81
Increase	$11,623.82

(b) Your income is increased to reflect your corrected share of the Western Construction Co. long term capital gain as follows:

One-sixth of Western Construction Co. long-term capital gain	$ 600.44
Reported in return	300.22
Increase	$ 300.22

(c) Your income is increased by the disallowance of the following unsubstantiated items which do not constitute necessary business expenses to you:

Car depreciation		$ 300.00
Less: One-half claimed by spouse		150.00
Claimed by taxpayer and disallowed		$ 150.00

(d) Your income is decreased by the elimination of so-called interest reported as having been received from your children as follows:

Roy W. Johnson	$719.42	
Evelyn L. Jorgens	719.42	
Eleanor J. Rector	719.42	$ 2,158.26
Less: Reported on return of spouse (½)		1,079.13
Reduction of income		$ 1,079.13

Since the transactions under which the purported liability of the children arose has been held to be ineffectual for income tax purposes, the interest entries are likewise held to be without substance and do not represent taxable income.

(e) Your income is decreased to allow for additional charitable contributions to be taken into account from the Western Construction Co. as follows:

One-sixth of Western Construction Co. contributions	$ 200.70
Claimed in return	100.35
Increase	$ 100.35

Computation of Tax

Your tax liability is correctly computed under the alternative tax method as follows:

1.	Net income	$28,972.99
2.	Minus: Excess of net long-term capital gain over net short-term capital loss	600.44
3.	Ordinary net income	$28,372.55
4.	Less: Surtax exemptions	500.00
5.	Balance (surtax net income)	27,872.55
6.	Surtax on line 5	11,900.98
7.	Ordinary net income	28,372.55
8.	Less: Normal-tax exemption	500.00
9.	Balance subject to normal tax	27,872.55
10.	Normal tax at 3 per cent	836.18
11.	Partial tax (sum of lines 6 and 10)	12,737.16
12.	Plus: 50% of line 2	300.22
13.	Alternative tax	13,037.38
14.	Income tax liability	13,037.38
15.	Liability disclosed by return, Account #3011849	6,507.57
16.	Deficiency in income tax	$ 6,529.81

Received and Filed T.C.U.S. August 11, 1947.

[Title of Tax Court and Cause.]

Docket No. 15500

ANSWER

Now comes the Commissioner of Internal Revenue, by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed herein, admits, alleges and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits the allegations contained in paragraph 3 of the petition.

4 (a), (b), and (c). Denies that in determining the deficiencies asserted in the statutory notice the respondent committed any errors, and specifically denies the allegations of error set forth in subparagraphs (a), (b) and (c) of paragraph 4 of the petition.

5(a). Admits that petitioner, as one of three alleged general partners doing business under the name and style of the Western Construction Company, in 1942 and 1943 purported to enter into certain limited partnerships and, among others, pretended to take into said business, as limited partners, petitioner's children, to wit: Roy W. Johnson, Evelyn Jorgens and Eleanor Rector. Denies each

and every other material allegation contained in subparagraph (a) of paragraph 5 of the petition.

5(b) and (c). Denies each and every allegation of error and of fact contained in subparagraphs (b) and (c) of paragraph 5 of the petition.

6. Admits that at approximately the same time as respondent issue the notice of deficiency in this porceeding determining the portion of the income of the Western Construction Company which is includible for Federal tax purposes, in the return of this petitioner for the years involved, the Commissioner also issued a notice of deficiency to the Western Construction Company asserting against it deficiencies in Federal income, declared value excess profits taxes and excess profits taxes on the basis that it is an association taxable as a corporation under the Federal revenue laws for the taxable years 1942 to 1945 inclusive. Alleges that the aggregate of the deficiencies so asserted against the said Western Construction Company, for the years stated, amounts to $728,832.16 instead of $594,735.72 as alleged by petitioner. Denies each and every other material allegation contained in paragraph 6 of the petition.

7. Denies generally and specifically each and every material allegation contained in the petition, not hereinbefore specifically admitted, qualified or denied.

Wherefore, it is prayed that the petitioner's ap-

peal be denied, and that the Commissioner's determination of deficiencies be approved.

/s/ CHARLES OLIPHANT, WHP
Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:
B. H. NEBLETT,
Division Counsel,

WILFORD H. PAYNE,
Special Attorney,
Bureau of Internal Revenue.

Received and Filed T.C.U.S. October 1, 1947.

[Title of Tax Court and Cause.]

Docket No. 15500

AMENDMENT TO RESPONDENT'S ANSWER

Now comes the Commissioner of Internal Revenue, by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, in accordance with Rule 17 of the Court's Rules of Practice and pursuant to oral motion on behalf of respondent which was granted by the Honorable Eugene Black, Judge of the Tax Court of the United States, at the hearing of this proceeding at Seattle, Washington, under date of May 26, 1948, by way of amendment to respondent's answer heretofore filed in the above-entitled cause and in order to conform his answer to the proof in the case, respectfully alleges and pleads, in the alternative, as follows:

8. In the event the Court should hold and determine that the limited partnership agreement with respect to Western Construction Company, which was executed February 24, 1942, and purporting to be effective as of January 2, 1942, should be recognized and given effect for Federal tax purposes as to the so-called limited partners, rather than taxing the entire partnership income to the general partners (and their spouses), then:

(a). The three equal general partners, J. A. Johnson, George J. Johnson and Albin Johnson are subject to tax with respect to one-half of the distributive partnership income (1/6 to each general partner) for the period January 2, 1942 to June 30, 1943 (the latter being the effective date of the second limited partnership agreement), instead of 45/105ths thereof (15/105ths as to each general partner) for the period during which the first limited partnership agreement was in effect, as reported in the individual income tax returns of said general partners and their spouses for the taxable years 1942 and 1943.

(b). Respondent hereby makes claim to any increase in the deficiency heretofore determined with respect to this petitioner which may result, as to each of the taxable years 1942 and 1943, by taxing each of the general partners (and his spouse) on 1/6 of the partnership income rather than 15/105ths thereof for the period January 2, 1942 to June 30, 1943.

(c). Effect may be given to respondent's alternative contention herein under a Rule 50 computation to be later submitted, in the event the decision of the Court with respect to the issues presented should require it, inasmuch as a Rule 50 computation will be necessary in any event in order to give effect to certain stipulations and concessions made by the parties at the hearing as to adjustments of income for the years 1942 and 1943.

Wherefore, it is prayed that petitioner's appeal be denied and that respondent's determination be sustained.

/s/ CHARLES OLIPHANT, WHP
Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel,

WILFORD H. PAYNE,
Special Attorney,
Bureau of Internal Revenue.

Received and Filed T.C.U.S. June 15, 1948.

Served June 17, 1948.

The Tax Court of the United States
Washington

Docket No. 15500

J. A. JOHNSON,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the determination of the Court as set forth in its Findings of Fact and Opinion promulgated March 22, 1950, the respondent herein filed a computation on June 1, 1950, which was not contested by petitioner when called for hearing July 13, 1950, now therefore, it is

Ordered and Decided: that there are deficiencies in income tax for the calendar years 1943 and 1944 in the respective amounts of $2,886.91 and $357.89; and that there is an overpayment in income tax for the calendar year 1945 in the amount of $232.81, which amount was paid within two years before the mailing of the notice of deficiency.

[Seal] /s/ EUGENE BLACK,
Judge.

Entered July 14, 1950.

Served July 14, 1950.

In the United States Court of Appeals
For the Ninth Circuit

T. C. Docket No. 15500

COMMISSIONER OF INTERNAL REVENUE,
Petitioner on Review,

vs.

J. A. JOHNSON,
Respondent on Review.

PETITION FOR REVIEW

To the Honorable Judges of the United States Court of Appeals for the Ninth Circuit

The Commissioner of Internal Revenue hereby petitions the United States Court of Appeals for the Ninth Circuit to review the decision entered by The Tax Court of the United States on July 14, 1950, that there are deficiencies for the calendar years 1943 and 1944 in the respective amounts of $2,886.91 and $357.89, and that there is an overpayment for the calendar year 1945 in the amount of $232.81, in respect of the Federal income tax liability of J. A. Johnson, the above-named respondent on review. This petition for review is filed pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

The respondent on review, J. A. Johnson, is a citizen of the United States, residing at 1619 East 52nd Street, Seattle, Washington, and having a

place of business at 605 Arctic Building, Seattle, Washington. Respond filed his Federal income tax returns for the years 1943, 1944 and 1945, the taxable years here involved, with the Collector of Internal Revenue for the District of Washington, whose office is located in Tacoma, Washington, and within the jurisdiction of the United States Court of Appeals for the Ninth Circuit where this review is sought.

Nature of Controversy

The respondent on review, J. A. Johnson, was, during the taxable years here involved, one of the general partners of the Western Construction Company. The Western Construction Company was created as a limited partnership under the laws of the State of Washington in 1942 and again in 1943. Its certificate of formation included J. A. Johnson, George Johnson and Albin Johnson, three brothers, as its general partners and their several adult sons and daughters as limited partners. The partnership was engaged during the taxable years here involved in the general contracting business. Prior to its organization the business had been conducted by a predecessor corporation known as Western Construction Company, Inc. In his determination of deficiencies in income, declared value excess profits, and excess profits taxes against the partnership, the Commissioner determined that the Western Construction Company, under the so-called limited partnership agreements of February 24,

1942 and June 30, 1943, constituted an association taxable as a corporation as prescribed by Section 3797(a)(3) of the Internal Revenue Code and Section 29.3797-5 of Regulations 111, and that the so-called partnership or association, rather than its individual members, was taxable on the income earned by it during the calendar years 1942 to 1945, inclusive. In the alternative, it was determined by the Commissioner that if the Western Construction Company was recognizable as a valid partnership, for Federal income tax purposes, its income was taxable entirely to its three general partners, one of whom was the respondent on review herein, rather than being taxable on a distributable basis to said general partners and the ten alleged limited partners, children of the three general partners.

The Tax Court of the United States disagreed with the Commissioner's determination and held that the Western Construction Company was a bona fide partnership composed of the three Johnson brothers and their several children as set out in the certificate of formation of the partnership and that it should be so recognized for tax purposes. Accordingly, in conformity with its opinion, the Tax Court entered its decision that there are no deficencies in income tax, declared value excess profits tax and excess profits tax for the calendar years 1942, 1943, 1944 and 1945 in respect of the partnership and, as to the respondent on review herein, J. A. Johnson, refused to hold that his three children were not taxable on their shares of the partnership income and

that such shares were taxable to their father, the respondent herein.

/s/ THERON L. CAUDLE, C.A.R.
Assistant Attorney General.

/s/ CHARLES OLIPHANT, C.A.R.
Chief Counsel, Bureau of Internal Revenue, Attorneys for Petitioner on Review.

Received and Filed T.C.U.S. October 9, 1950.

[Title of Court of Appeals and Cause.]

T. C. Docket No. 15500

STATEMENT OF POINTS

Comes Now the Commissioner of Internal Revenue, petitioner on review in the above-entitled cause, by and through his attorneys, Theron L. Caudle, Assistant Attorney General, and Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, and hereby states that he intends to rely upon the following points in this proceeding:

The Tax Court of the United States erred:

1. In entering its decision that there are deficiencies in income tax for the calendar years 1943 and 1944 in the respective amounts of only $2,886.91 and $357.89, and that there is an overpayment in income tax for the calendar year 1945 in the amount of $232.81.

2. In failing and refusing to sustain the de-

ficiencies in tax determined by the Commissioner on the basis that the taxpayer was taxable upon one-third of the net income of the business conducted under the name of Western Construction Company, less the community portion of such income allocable to taxpayer's wife, as modified by stipulation and agreement of the parties in respect of items not now in controversy.

3. In holding and deciding that the Western Construction Company is a bona fide partnership composed of the three Johnson brothers and their several children as set out in the certificate of formation of the partnership and is recognized as such for tax purposes.

4. In failing and refusing to hold and decide that the Western Construction Company, during the taxable years involved, was a partnership consisting only of its three general partners, and that for Federal income tax purposes the income of such partnership was taxable to the general partners and their respective spouses and that the children of the general partners should not be recognized, for Federal income tax purposes, as bona fide partners in the business conducted by the said Western Construction Company.

5. In that its opinion and its decision that, for Federal income tax purposes, the Western Construction Company is a bona fide partnership composed of the three Johnson brothers and their several children as set out in the certificate of forma-

tion of the partnership is not supported by but is contrary to the evidence.

6. In that its opinion and its decision are not supported by but are contrary to the evidence.

7. In that its opinion and its decision are contrary to law and the Commissioner's regulations.

/s/ THERON L. CAUDLE, C.A.R.
Assistant Attorney General.

/s/ CHARLES OLIPHANT, C.A.R.
Chief Counsel, Bureau of
Internal Revenue.

Statement of service attached.

Received and Filed T.C.U.S. December 21, 1950.

[Title of Tax Court and Cause.]

Docket Nos. 15495, 15496, 15497, 15498, 15499, 15500, 15586, and 15588

STIPULATION OF FACTS

It is hereby stipulated and agreed by and between the parties hereto, through their respective counsel, that the above-entitled related cases may be consolidated for purposes of hearing before the Tax Court, and that insofar as applicable to the issues involved the evidence presented may be regarded as evidence in each of said cases. It is further stipulated that in addition to the facts established by the pleadings, the following facts may be accepted as true, without

the introduction of any further evidence by the parties with respect to the matters so stipulated:

1. The Western Construction Company is or was a so-called limited partnership (or partnerships) for the years 1942 to 1945, inclusive, organized and operating under the laws of the State of Washington, with its principal place of business at Seattle, Washington. The respondent has determined that said so-called limited partnership constitutes an association taxable as a corporation for the taxable years 1942, 1943, 1944 and 1945, under the provisions of the Internal Revenue laws and regulations, which issue is to be presented for determination in Docket No. 15495.

2. The so-called general partners of the said Western Construction Company for the years involved consisted of J. A. Johnson, George J. Johnson and Albin Johnson. The so-called limited partners consisted entirely of the sons and daughters of the three general partners.

3. Petitioners J. A. Johnson and Ellen M. Johnson are husband and wife. Petitioners George J. Johnson and Huldah Johnson are husband and wife. Petitioner Albin Johnson is the husband of Rose Johnson, whose tax liability is not involved before the Tax Court for the years under consideration. Petitioner Lloyd W. Johnson (one of the so-called limited partners) and petitioner Roberta M. Johnson are husband and wife. The taxable income attributable to Ellen M. Johnson, Huldah Johnson and Roberta M. Johnson arises by reason of their

community property interest in the income of their respective spouses under the community property laws of the State of Washington.

4. In the event it should be determined by the Court that Western Construction Company is not an association taxable as a corporation under the Internal Revenue laws and regulations for the years involved, but is a partnership, the income of which is taxable to the three general partners, J. A. Johnson, George J. Johnson, and Albin Johnson, it is then agreed that each of the three general partners is entitled to a further community deduction of $1,200.00, but no more, for each of the years 1942, 1943, and 1944, in excess of that determined and allowed by respondent in the deficiency notices, as business expenses covering depreciation, insurance and operating expenses of automobiles, and also entertainment and travel expenses. The adjustments in such personal expenses of the general partners with respect to their community income for the year 1945, as shown in the deficiency notices, are proper and are hereby accepted by the parties.

5. In the event the Court should hold that the limited partnership agreements involved in these proceedings are to be recognized for Federal tax purposes and that the income of the business conducted in the name of Western Construction Company is taxable to the general and limited partners as contended by petitioners, then it is agreed that the personal community expenses of the three general partners are as stated in paragraph 4 above,

but reserving to respondent the right and privilege of contending and maintaining that the amounts so expended by the three general partners do not constitute deductions which may be allowed in their entirety to said partners in determining their tax liability.

6. For the taxable year 1945 certain salary payments were made by the Western Construction Company in contravention of the Salary Stabilization Act of 1942, as a result of which it is agreed that the amount of $500.00 should be disregarded as costs of its operations for said year. The said sum of $500.00 was not taken into account by the respondent in determining the community net income and the tax liability of the respective general partners as set forth in the statutory notices. It is agreed that upon the determination by the Court of the liability of the Western Construction Company as an association, or the liability of the individual partners, in the event it is determined that the income is taxable on a partnership basis either to the three general partners equally or to them and the limited partners in other proportions, that the sum of $500.00 may be disallowed as a deduction for 1945 and that effect may be given thereto in Rule 50 computations to be submitted after the opinion of the Court is rendered in these proceedings.

7. The gross profit reported in the income tax return of the Western Construction Company for the year 1945 on the "Boeing Alterations Contract,"

in the sum of $7,571.12, does not constitute taxable income for that year but is properly taxable for the year 1946 when the contract was completed. Appropriate adjustments may be made with respect to that item either in the income of the Western Construction Company or of the respective partners for the year 1945, dependent upon the determination of the litigated issues, by the Court, with respect to said proceedings.

8. (Relating only to Albin Johnson, Docket No. 15496.) In the event it is determined that the income of Western Construction Company is taxable on a partnership basis, rather than as an association taxable as a corporation, it is then agreed that the salary of $15,000.00 which was paid to Albin Johnson for each of the years 1942, 1943, 1944 and 1945, constitutes community income and that the remainder of Albin Johnson's partnership income for said years constitutes separate and community income in the following percentages:

Year	Separate Income	Community Income
1942	20.47%	79.53%
1943	35 %	65 %
1944	44.46%	55.54%
1945	48.87%	51.13%

/s/ RALPH B. POTTS,
Counsel for Petitioners.

/s/ CHARLES OLIPHANT, W.H.P.
Chief Counsel, Bureau of Internal Revenue, Counsel for Respondent.

Filed at Hearing May 25, 1948.

Before the Tax Court of the United States

Docket Nos. 15495, 15496, 15497, 15498, 15499, 15500, 15586, and 15588

In the Matter of:
WESTERN CONSTRUCTION CO.,
ALBIN JOHNSON,
ELLEN M. JOHNSON,
HULDAH JOHNSON,
GEORGE J. JOHNSON,
J. A. JOHNSON,
ROBERTA M. JOHNSON,
LLOYD W. JOHNSON,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PROCEEDINGS

May 24, 1948, 9:30 A.M.

(Met pursuant to notice.)

Before: Honorable Eugene Black, Judge.

Appearances:

RALPH B. POTTS,
1702 Hoge Bldg., Seattle, Washington,
Appearing for Petitioners.

WILFORD H. PAYNE,
Counsel, Bureau of Internal Revenue,
Smith Tower, Seattle, Washington,
Appearing for Respondent.

* * *

Mr. Potts: Mr. J. A. Johnson, will you take the stand?

Whereupon,

J. A. JOHNSON

a witness on behalf of the Petitioners, was duly sworn and testified as follows: [35*]

Direct Examination

By Mr. Potts:

Q. Will you state your full name, Mr. Johnson? Just sit down, Mr. Johnson.

A. John August Johnson.

Q. Where do you reside, Mr. Johnson?

A. 1619 East 52nd Street.

Q. In Seattle, Washington?

A. In Seattle.

Q. How long have you been a resident of the State of Washington?

A. Since 1905—July, 1905.

Q. Are you a citizen of the United States, Mr. Johnson? A. Yes, sir.

Q. A native or naturalized?

A. I am naturalized.

Q. Where were you born?

A. I was born in Sweden.

Q. Where were you naturalized—in what jurisdiction? A. In Seattle.

Q. In Seattle, here? A. Yes, sir.

Q. When did you come to the United States?

*** Page numbering appearing at top of page of original Reporter's Transcript of Record.**

(Testimony of J. A. Johnson.)

A. I came here on the 16th of July, 1905. I came here from Canada. [36]

Q. What is that?

A. I came here from Canada.

Q. And how long were you in Canada?

A. From 1901.

Q. And what work did you pursue after you came to the New World?

A. Carpenter work.

Q. Will you tell the Court how long you pursued that work, and what became of it?

A. I worked at carpenter work in Winnipeg, Canada, and I started out here in Seattle—doing carpenter work as well as being a foreman. I worked at carpenter work, and was a foreman in Winnipeg, and I started the same thing here in Seattle after I had been here a few months. And in 1909 George Johnson and myself went into business together—into a partnership.

Q. You have referred to a George Johnson?

A. Yes.

Q. Who is he? A. My brother.

Q. Give us the year again.

A. 1909. In the summer of 1909.

Q. And you formed a partnership with him, as I understand it? A. Yes, sir. [37]

Q. What work did you and your brother do?

A. Oh, at that time, on account of the lack of capital we were doing mostly residential work—working on residences.

(Testimony of J. A. Johnson.)

Q. When you say "residences,"—you mean building homes, is that it?

A. Yes. And after a few years we went into larger buildings and different kinds of construction.

Q. What was the name that you and your brother operated under in the partnership?

A. We went under the name of Johnson Brothers at that time.

Q. Now, coming down to the year 1934 did you do anything about extending your partnership?

A. I think it was in 1917 that we changed the name to Western Construction Company. But then in 1934, due to the depression, and due to lack of capital at that time, we took Albin Johnson in with us—our other brother.

Q. Who is Albin Johnson?

A. That is the other brother who is now with us in the Western Construction Company.

Q. Now, what kind of work did you do after 1934—immediately after?

A. We had that job at Coulee.

Q. Tell the Court what that job was. [38]

A. We took a contract to build two bridge piers there and a water pier, and due to the raise in wages particularly—100 per cent—was due to inspectors insisting on raising the wages, we lost considerable of our money on those jobs.

Q. After you got through with this job at Coulee Dam what was the financial condition of the partnership? A. We were pretty badly bent.

(Testimony of J. A. Johnson.)

Q. What happened after that?

A. We organized then into a corporation on the advice of our banks and our bondsmen that by doing that we could go ahead and take other work and be able to earn enough so that we would be able to pay off the indebtedness without somebody coming and grabbing our finances and making it impossible for us to do business.

Q. As general partners before this corporation was formed what was your personal financial condition, say with respect to your homes, and so forth?

A. Well, at that time we had our homes and everything that we had pledged to the bank.

Q. All right. Now, who formed this corporation?

A. It was with three brothers, including our sons and our——

Q. (Interposing): Who were the incorporators?

A. Well, it was myself, and George Johnson, and Albin Johnson, and Roy, my son, and George Johnson's son, Lloyd [39] Johnson, and our bookkeeper.

Q. Aren't you mistaken? Wasn't it just Roy Johnson, Lloyd Johnson and Lucille Easterbrook?

A. I realize now that they were the incorporators, and myself and my brothers were interested in it, but not in the incorporation exactly.

Q. Who had the stock issued to them, and who subscribed for the stock in that corporation?

A. It is beginning to get kind of vague to me now.

(Testimony of J. A. Johnson.)

Q. Well, I will take that up later. You may have the opportunity to refresh your mind from the records. Now, what happened to the corporation?

A. As soon as we were able to make enough to pay off the indebtedness we were disincorporated again.

Q. Well, I will have to take that matter up later. You do not know what happened to the stock in the corporation?

A. The stock in the corporation was given back to the partnership, I believe.

Q. You mean to yourself, George Johnson and Albin Johnson? A. Yes, sir.

Q. Was there anything given to the incorporators for their interest in that stock?

A. Yes, they were given a partnership in the company—in the partnership. [40]

Q. When you say "they," whom do you mean?

A. Roy Johnson and Lloyd Johnson.

Q. Was anything given to the incorporators for their interest in that stock?

A. Yes; they were given partnerships in the company, in the partnership.

Q. Who?

A. Roy Johnson and Lloyd Johnson.

Q. You say "were given partnerships"; in what partnership?

A. In the Western Construction Company.

Q. Do you recall the date of that partnership; the formation of it? A. Not exactly.

(Testimony of J. A. Johnson.)

Q. Well, after this partnership, this interest, was given to Lloyd and Roy, what business did you do?

A. Well, we kept on with the same building business. I could mention some of the contracts we took.

Q. That was what time; about what year was the corporation dissolved?

A. 1941, I believe.

Q. 1941? A. Yes.

Q. And what was your partnership's condition as to capital? [41]

A. At that time we were very weak, financially.

Q. Did you make any effort to get new capital at that time?

A. Yes; we tried courses, particularly——

Q. Just turn to the court and tell the court what efforts, if any, you made to get new capital at that time.

A. Mr. Phillip Johnson, head of Boeing's at that time, I went to see him to see if we could interest him to help to finance it, but he wasn't interested. We went and seen Mr. Frank Grandstone of University Building Company. We had had a little financial set-back before and it wasn't easy to interest anybody.

Q. Were you successful in—— A. No.

Q. ——in getting anybody to put money into the partnership at that time in 1941?

A. No. We tried to get other construction companies interested in going with us, and take work

(Testimony of J. A. Johnson.)

with us, and we figured some job even before that together with some construction company like a fellow by the name of La Gossa, or something, up at Yakima; but when we took a job of that kind you can't control the amount of the bids that go in for it and, consequently, we couldn't get the work and finally we got together with our brother, Mr. E. R. Erickson, our brother-in-law, and interested him to go in with us. We [42] thought that he had some money.

Q. Now, what business name did you assume?

A. West Coast Construction Company.

Q. And did you make an arrangement with him to go in together and take some work?

A. Yes.

Q. What work was that?

A. That was the West Park housing job out at Bremerton.

Q. Did he have any capital?

A. We were made to believe that he had about sixty thousand dollars which he was supposed to put up so much cash and we were supposed to put up so much cash after we had the job, but after we got the job and put up the bond and so on, when it came to put up the cash in the bank, he didn't have any. He had quite a few jobs and we didn't know the status of those jobs at that time, but later on it proved that those jobs were bad jobs that he had and he was worse than broke.

Q. After you got through the West Park project there—first of all, can you tell us the time of the

(Testimony of J. A. Johnson.)

year and the year that you got through with that West Park housing project?

A. They started that about the 12th of December, 1940, and they finished that in, substantially finished, in October but the planting and garden work. That could not be done during the summer. We had to leave some of that work until in the fall and that was finished some in the fall of [43] 1941, and I believe it was probably January or February before it was all completed.

Q. Now your attention is called to a limited partnership consisting of the three general partners, yourself, George Johnson, and Alvin Johnson, and Lloyd Johnson and Roy Johnson, Weston Johnson, Ellen I. Rector, Bernice J. Wallin, and Elsie Keil.

Mr. Potts: May this be marked?

The Court: It will be marked as Petitioner's Exhibit Number 1.

(The document referred to was marked Petitioner's Exhibit 1 for identification.)

Q. (By Mr. Potts): Was there such a partnership formed?

A. I didn't get it.

Q. Was there a partnership formed of yourself, George Johnson and Alvin Johnson, and the limited partners I have just read? A. Yes.

Q. And can you give us the approximate date?

A. I think it was February the 24th, 1942.

Q. Showing you——

(Testimony of J. A. Johnson.)

Mr. Payne: If your Honor please, could I make one request at this time? We have explained rather fully to the court the nature of the issues. My only request is [44] with reference to terminology. I don't wish to be jumping up and objecting, and can we have it understood now that whatever terms we use, limited partnership, general partners, it is subject to the——

The Court: That is always understood, Mr. Payne. We never——

Mr. Payne: Just so that we needn't be petty about our objections.

The Court: Either party can characterize what was done in their own terms, of course.

Q. (By Mr. Potts): Showing you Petitioner's Exhibit 1, marked for identification, this is a photostatic copy, so I will ask you if you can examine it and see if this is a true photostatic copy of the articles of that so-called partnership I just interrogated you about?

A. Yes; this is a copy of that copartnership; yes, February 24, 1942.

Mr. Potts: We offer, if the court please, the certified photostatic copy, from the records of the County Auditor's Office of King County, the certificate of formation of a limited partnership. The name: Western Construction Company.

Mr. Payne: No objection.

The Court: It will be received as [45] Petitioner's Exhibit Number 1.

(Testimony of J. A. Johnson.)

(The document heretofore marked Petitioner's Exhibit 1 was admitted in evidence as Petitioner's Exhibit 1.)

Q. (By Mr. Potts): Now, Mr. Johnson, can you tell the court your reasons for forming this limited partnership and will you tell him who the limited partners are?

A. The limited partners are as already mentioned, our children, the boys and the girls.

Q. Now, take your own children; who were your children that formed this limited partnership?

A. My son, Roy Johnson, and Ellen.

Q. Will you give us his age at the formation of this partnership? At the time of the formation of this partnership——

A. About thirty-five (35), I guess.

Q. What had been Roy's education?

A. He has worked and studied engineering; he took that up in school and University until graduated as a civil engineer.

Q. At what University?

A. University of Washington.

Q. Here in Seattle? A. Yes. [46]

Q. Now, would you go on to the next child; who is the next child?

A. Ellen Rector; Mrs. Rector now.

Q. Yes?

A. She took up medicine at the University and then at St. Louis, Missouri, and she interned—I can't think of the hospital there—on the East Coast.

(Testimony of J. A. Johnson.)

Q. Johns Hopkins?

A. Yes. And then she got a scholarship to go back to England, so that she was there when the war broke out and she was there practically a year on account of she couldn't get back. After she came back from there both she and her husband went into practice.

Q. What was that time that they entered practice, approximately?

A. It was just after the war started.

Q. In 1942?

A. About 1940, I think it was; maybe 1939.

Q. Did she specialize in anything?

A. She was a pediatrician.

Q. Is that a——

A. A child specialist.

Q. A specialist in the care of children and infants? A. Yes.

Q. And about what was her age at the time of the [47] formation of this partnership?

A. She is two years older than Roy, so she must have been about thirty-seven (37); she is now about forty.

Q. All right; *we* will be about forty-two (42) now? A. Yes; 42 now.

Q. Now the third who was a limited partner?

A. That was Evelyn.

Q. What was her last name?

A. Mrs. Jorgens.

Q. Was she married? A. Yes.

(Testimony of J. A. Johnson.)

Q. And where did she live?

A. She lived in Spokane.

Q. That is in the State of Washington?

A. Yes.

Q. What was her husband's occupation?

A. He was working as a—in a big printing establishment there in Spokane, looking after the printing presses; I have forgotten what they call them.

Q. Is he a pressman?

A. A pressman; yes.

Q. And what was Evelyn's and her husband's approximate ages at the time of the formation of this partnership?

A. About thirty; he was a little older, about thirty-five [48]

Q. What property, if any, did they own at that time?

A. They had their own home at that time and a few other things; nothing real big, but they had considerable assets at that time.

Q. Did they own some real estate besides their home?

A. Yes; I think they had a summer home.

Q. Up on the lake?

A. Up on the lake somewhere; yes.

Q. Near Spokane? A. Yes.

Q. Do you know about what his earnings were at the time of the formation of this partnership; Mr. Jorgen's?

A. No, I am not plain on that.

(Testimony of J. A. Johnson.)

Q. He was a pressman though, you say?

A. Yes.

Q. Now, did you have any other children at that time? A. Yes; I had a younger girl.

Q. What was her age?

A. Her age was about 18.

Q. She was not taken in as a limited partner?

A. No; she was working for us also at the time as a stenographer in the office.

Q. What was the reason she wasn't taken in as a limited partner when her sister and brother was?

A. She wasn't of age. [49]

Q. Now, will you tell the court about Roy? What work, if any, had he done prior to the formation of the limited partnership for the partnership of the Western Construction Company?

A. In fact, both Roy and Lloyd worked for the company every year during the vacations from school. Roy and Lloyd worked for us, both of them, when they built the Schaffer Building across the street from Frederick and Nelsons. At that time Roy was thirteeen and Lloyd about twelve and they worked during vacation and during the school Roy was helping us sometimes on false work and drawings and engineering of that kind that we needed.

Q. You have mentioned false work drawing; will you explain that?

A. When building a drawing, you have to have false work to build it on; you have to have a certain amount of truss work before you can pour the concrete and that was something not assigned by

(Testimony of J. A. Johnson.)

the state or city or whoever took bids on *this bridges.* It was up to the contractor to submit drawings for that purpose and Roy always took care of that for us and as soon as he got through the University, then we got into this hard times and he went and worked for different other companies like the Boeings and then for the City of Portland.

Q. What work did he do down there in [50] Portland?

A. He had charge of the putting in of the new street car system or bus system.

Q. The electric trolley coaches?

A. Yes; and he worked at Bonneville Dam for the Army Engineers; and he was up at Lake Chelan working for the mining company up there for a while.

Q. That is the How Sound Company?

A. Yes.

Q. When this company was formed——

A. Excuse me; and then he come back to Seattle and had charge of putting in the trolley lines here in Seattle also; the bus trolley lines; he had charge of that.

Q. Now, referring to the date of the limited partnership, we have just introduced as Exhibit Number 1, the articles, what did Roy do, or was he doing, at that time, February 24, 1942?

A. I am not absolutely sure whether he had started again with us then or whether he started shortly afterwards. I think he started shortly afterwards.

(Testimony of J. A. Johnson.)

Q. All right. Now, will you tell the court the purpose of forming this limited partnership? Why did you form it? What was your intention in forming this limited partnership?

A. In order to make use of our children, particularly the boys, in construction because they were all trained in [51] that particular business and it was to straighten our finances.

Q. What about your daughter's husband?

A. Well, like Stanley Jorgens; I was trying to interest him.

Q. You say Stanley Jorgens; identify him for the court. A. He is Evelyn's husband.

Q. He is the pressman living in Spokane?

A. Yes; I was trying to interest him to come to Seattle and come in with us, but due to the uncertainty of this here he wasn't too sure about doing that, but he was willing to come in with us and help us financially.

Q. All right. Now, what about Mr. Gustafson, the husband of George Johnson's daughter Rachel?

A. Well, Gustafson worked for us for quite a long time, up until the worst part of the depression, and when he went back he went into another business.

Q. What was his education?

A. Well, he started in as a premedical student, but he, my brother George, advised him to take engineering instead so that he changed from premedics to engineering and he was working for us when he intended to go in this other business be-

(Testimony of J. A. Johnson.)

cause he worked for this fellow with the butcher shop during his vacation in school and he knew that business, and I suggested at that time that you would do better in [52] contracting work than the meat business, but not the way things look now. So he went back in that business because this friend of his wanted to sell out for some reason or another, but we tried again to get him to come with us because he was a valuable man. He had graduated from engineering and he was the kind of a fellow we could get along with and we would like to see him with us in the business, and we thought by getting them to come in and invest with us that we would finally get him to come in.

Q. All right. Now, what about—well, I don't think I will take that up yet. What about Roy Johnson, George's oldest son?

A. He was working with us right along, but the same thing happened there. During the depression, why, he got interested with another company, a fellow by the name of Kuney, and he had worked for him on the job up in Montana, if I remember, and this Kuney offered Lloyd a good proposition if he would go in with him, so Lloyd went with Kuney on a job or so, but as far as I understand, even though he was working with Kuney, he would come down evenings, and sometime during the day, and go over bids with us and look over estimates and one thing or another, and then he even helped us with estimates and consulted, being that he was also a graduate engineer.

(Testimony of J. A. Johnson.)

Q. Did or did not Roy Johnson's going with Kuney have [53] any part in your intentions to form this limited partnership?

A. Well, we formed the limited partnership with the intention that we would be able to keep these boys with us and continue the business. We realized, both George and myself, that we were getting pretty well up in age and we were in hopes that our families could stick together and keep on the business.

Q. What was your age at the time of the formation of the limited partnership?

A. Well, I will be seventy (70) my next birthday in January.

The Court: It would be about sixty-four (64), I guess.

The Witness: Sixty-four (64); yes.

Q. (By Mr. Potts): And do you know George's age at that time?

A. He was two years younger than I.

Q. Sixty-two (62) then? A. Yes.

Q. What was Alvin's age?

A. About ten years younger than I am.

Q. He was about fifty-two (52) at that time?

A. I think he is twelve (12) years younger than I am.

The Court: That would be about fifty-two. We will take a recess for ten minutes now. [54]

(Whereupon, at 11:15 o'clock a.m., a recess was had until 11:25 o'clock a.m.)

(Testimony of J. A. Johnson.)

The Court: All right.

Mr. Potts: Mr. Reporter, would you read the last question?

(Whereupon, the following was read by the reporter:)

"Q. He was about fifty-two (52) at that time?

"A. I think he is twelve years younger than I am.

"The Court: That would be about fifty-two (52)."

Q. (By Mr. Potts): Now, did Alvin have a son?

A. Yes.

Q. What was that son's name?

A. Winston Johnson.

Q. And about what was his age at that time, just approximately?

A. About twenty-four (24).

Q. What was that?

A. About twenty-four (24) or twenty-five (25).

Q. What had been his education?

A. He had also had three years in the University in engineering.

Q. Had his education been interrupted by the War, do you know? A. Yes. [55]

Q. What branch of the service was he in?

A. I believe some kind of construction work he was in.

Q. Was he in the army engineer corps?

(Testimony of J. A. Johnson.)

A. Yes; army engineers; yes.

Q. Now, with respect to the limited partnership, how were the investments of your children made?

A. They borrowed, together the three of them, twenty (20) thousand dollars.

Q. From whom?

A. I borrowed them the money and they gave a note for it.

Q. They gave a note for it? A. Yes.

Mr. Potts: We would like the privilege of substituting for these notes photostatic copies later on.

The Court: You may have that privilege.

Mr. Potts: May we have this marked; we can mark the three together.

The Court: Yes. Petitioner's Exhibits 2, the three of them together.

(The document referred to was marked Petitioner's Exhibit 2 for identification.)

Q. (By Mr. Potts): Showing you Petitioner's Exhibit 2, marked for identification, consisting of three sheets of paper, will you [56] tell us what that exhibit is?

A. That is a note from Ellen Recton and a note from Roy Johnson and a note from Jorgenson, $6,666.66.

Q. $6,666.66; is that correct? A. Yes.

Q. Each of the notes are in that amount?

A. Yes.

Q. And will you tell us the dates of these notes?

A. April 21, 1942.

(Testimony of J. A. Johnson.)

Q. And the terms; is that expressed there?

A. It is four per cent interest and——

Q. When is it payable?

A. One year, April 1, 1943.

Q. Each of the notes are the same in that respect, are they? A. Yes.

Q. On Evelyn Jorgen's note it seems to be payable April 21, 1942, but that——

A. ——it is a mistake. It is given one year here somewhere.

Q. It says one year in the body of the instrument? A. Yes; one year.

Mr. Potts: We offer them, if the Court please, the photostatic copies. I will show these to Mr. Payne.

Mr. Payne: No objection, your Honor. [57]

The Court: The three will be attached together and received as Petitioner's Exhibit Number 2.

(The documents heretofore marked Petitioner's Exhibit 2 was admitted in evidence as Petitioner's Exhibit 2.)

Q. (By Mr. Potts): Now, when these notes were given, Mr. Johnson, did you have any arrangement or understanding with the children as to the payment of these notes?

A. We had this arrangement that the notes was to be paid.

Q. What was that?

A. Yes, it was the understanding that they would pay the notes.

(Testimony of J. A. Johnson.)

Q. Was there any understanding that if the business should be a failure that they wouldn't have to pay the notes?

A. The notes were payable either one way or another, but if it was a failure, then they would have to come in and pay it.

Q. Did they understand that?

A. Of course they understood that.

Q. Did you make it plain to them at the time?

A. They were all old enough to know that if they were giving a note it wouldn't be given to just give it; it was given to back up with it. [58]

Q. Now, in that respect, in regard to these notes, will you tell the court the purpose of these notes, in obtaining these notes?

A. In order to strengthen our financial situation.

Q. At that time, in April of 1942, did you need additional finances?

A. In the contracting business it is just like this; you can take a contract for twenty-five thousand dollars, for instance. You wouldn't need so much financial help. But, if you take a contract of that size, you have to be there and supervise it and do practically all of it yourself and go and work with pick and shovel and do it yourself or you couldn't possibly come out because the competition is so great. When it comes to one hundred thousand dollars, it is a little bit better. Competition isn't quite so bad. When it comes to a couple of million dollars, it is better because you haven't got the competition. But when it is a small contract which

(Testimony of J. A. Johnson.)

the average person can handle, the competition is much greater. That is the reason we wanted to have more financial backing so that we could take larger contracts and be able to furnish the bond and get the backing from the bank so that we could carry it through. The most difficult thing in our construction work has been to get the bonding company to furnish us the bond.

Q. Now, with these notes, did you or did you not use [59] them for the purpose of securing credit?

A. Correct; that is what we had them for.

Q. Did you use them for the purpose of securing credit? A. Yes; we did.

Q. Can you tell the court any instances in which you put the notes on any financial statement?

A. We put them on our financial statement to the bank and also to the bonding company.

Q. Did you do that as an individual or as a general partner or both?

A. I think, I am not absolutely sure whether they were put in there in a general partnership because this was our individual assets, but our individual assets was put on the statement and when I made an individual report to the bank, then I had those down there.

Q. Can you tell us of any banks that you remember now with whom you might have filed a statement listing these notes?

A. With the Seaboard Branch of the First National Bank of Seattle.

(Testimony of J. A. Johnson.)

Q. With the Seaboard Branch of the Seattle First National Bank? A. Yes.

Q. Now, have you told us how long Roy worked for the limited partnership after the limited partnership was formed? [60]

A. He worked until in the summer of 1944.

Q. And what work did he do?

A. He worked as an engineer laying out surveying and laying out work on the ground and also in the estimating and also as supervisor. At Renton, or the Renton Housing Project he did both the engineering and also helped me in the office with estimating. At Boeings when we were down there——

Q. What work did you do for Boeings?

A. We built the Boeing Cafeteria and the food service building and he did the engineering on both jobs and had supervision on the food service building.

Q. There was some special construction work on that Boeing Cafeteria, was there not, dealing with engineering problems?

Mr. Payne: If your Honor please, I will have to object to some of these questions being leading.

Mr. Potts: They are; that I realize.

The Court: Well, be careful and not lead your witness.

Mr. Potts: Yes.

Q. (By Mr. Potts): What was the construction of the Boeing Cafeteria, Mr. Johnson?

(Testimony of J. A. Johnson.)

A. Well, it is almost on any job and it is definitely on any large job that you need engineering. You need a man [61] to have practical experience and also technical experience and knowledge and that was quite a severe job to lay out on account it was not a square building but had all kinds of corners on it.

Q. What about the roof of that building?

A. It was a difficult roof. It was over 100 feet span in the arches there.

Q. One hundred foot span in the arches?

A. Yes.

Q. Who did the engineering on that?

A. Roy did the engineering on it.

Q. Are you an engineer? A. No.

Q. Are any of the general partners engineers?

A. No; we didn't have the privilege that the young fellows have now.

Q. All right; what other work did Roy do for the partnership?

A. Well, he worked on the transit shed with my brother.

Q. For whom was that building constructed?

A. For the army down there on Fourth Avenue.

Q. In Seattle?

A. Seattle. That is the big building. I don't remember the amount of the contract, but it covers an awful lot of area and he did engineering work down there together with [62] my brother and then they built two docks for the City of Seattle; and he was also doing the engineering work there.

(Testimony of J. A. Johnson.)

Q. Did he act in an executive capacity in any of this work?

A. With respect to estimating because together with the work there always came a lot of estimating.

Q. Now, do you know the circumstances that compelled Roy to leave the partnership in 1944?

A. Why this engineer up at Juneau that had been sort of getting that electrical power unit, started getting it organized, had met Roy and was personally acquainted with him and he come out here to see Roy and ask him if he wouldn't undertake to do the engineering on it, and that was tempting for him to undertake.

Q. I didn't get that; that was what?

A. That was tempting for him to take.

Q. Tempting?

A. Yes. So against my will he went up there. I wanted him to stay with us at that time but he said there wasn't anything so pressing right then. We were sort of slack on work and he went up there to do the engineering. As we got up to Spokane on this job, the Velox Naval Supply Depot, I was trying on that job to get Roy to come back because this man, Johnstone, in charge of that job insisted on that we name all the men that we wanted to help us. He questioned us, [63] and particularly our ability to handle it and handle it in as short a time as necessary to get it built and at that time I named Roy as one of the engineers and also Lloyd and was in hope that if we got in a pinch we could get them both over there to help us, but as

(Testimony of J. A. Johnson.)

we got started we got ahold of a number of the foremen that we had here in Seattle and got them to go there with us and Johnstone eased up a little bit when he saw things begin to go; so that I never did put pressure on Roy to come back there and help us.

Q. Now, you spoke of listing Roy and Lloyd; what do you mean by that, on these jobs? Will you explain that to the court?

A. This Commander Johnstone asked us to list all our personnel that we could have.

Q. What kind of personnel? You mean carpenters?

A. No; the technical staff that we could have.

Q. And you had listed, as I understand your testimony, Roy and Lloyd?

A. Yes; and Winston also.

Q. Now, what happened to Roy's connection with the company; how long was he away?

A. Oh, he was away, he expected to be away only that summer, but due to when they got started on the work there they couldn't get any men, they couldn't finish and it took the following year to finish the job. [64]

Q. Aren't we getting a little ahead; you said to finish the job. What did he go up there originally for?

A. Just to make the drawings, the engineering part of it.

Q. But did he do other than the engineering?

A. When they got the bids they only got a

(Testimony of J. A. Johnson.)

couple of bids locally and they was away out of line so that the counsel at Ketchikan asked him to go ahead and do it. First on cost plus but due to the fact that it had federal money in it, it wasn't permissible so then they asked him to take it on a contract. Then he went ahead and took a contract on it and expected to get it finished that summer.

Q. In that connection with that contract, did he or did he not approach the partnership regarding that matter?

A. Yes; he wanted us to go up there and take the job but by that time we had this Spokane job and I wasn't interested in going up to Ketchikan to handle that job.

Q. All right; now after the bid, did you testify he did take the job?

A. He took the job; yes.

Q. And was it completed before the year 1945?

A. Yes. No. 1946.

Q. Now, with respect to Winston Johnson, and after the formation of the limited partnership, what was his connection with the partnership? [65]

A. He was in the office most of the time.

Q. What kind of work did he do?

A. Doing estimating.

Q. Now, will you tell the court just what estimating work consisted of?

A. To take off the quantities from the plan and see how many yards of concrete and how many feet of form and how much lumber and how much excavation and so on.

(Testimony of J. A. Johnson.)

Q. And is that a major part of the contracting work; the important part?

A. That is the most important part of contracting work, to get the quantities and get them correct so that when you price the job you don't find that you have a lot more material to handle than what the estimate was. That is really important and the next important is to get together and price it and that is why we got Lloyd to come in and talk it over and how much it would cost to do the work because you couldn't go by previous experience; you had to get new experience almost every month due to the changing of prices; everything was going up so fast.

Mr. Potts: We are going to have then, if the court please, the second limited partnership marked for identification.

The Court: It will be marked as Petitioner's Exhibit Number 3. [66]

(The document referred to was marked Petitioner's Exhibit 3 for identification.)

Mr. Payne: No objection.

Mr. Potts: We offer, then, the second limited partnership in evidence.

The Court: It will be received in evidence as Petitioners' Exhibit Number 3.

(The document heretofore marked Petitioner's Exhibit 3 was admitted in evidence as Petitioner's Exhibit 3.)

(Testimony of J. A. Johnson.)

PETITIONER'S EXHIBIT No. 3

Certificate of Formation
of a
Limited Partnership

State of Washington,
County of King—ss.

We, J. A. Johnson, George Johnson, Albin Johnson, Roy W. Johnson, Lloyd W. Johnson, Winston A. Johnson, Eleanor J. Rector, Evelyn L. Jorgens, Bernice K. Wallin, Elsie Kiel, Vedola H. Johnson, Lorraine J. Ellingson, and Rachel Gustafson, the subscribers, having formed a limited co-partnership pursuant to the laws of the State of Washington, do hereby certify and state:

I.

That the name of the co-partnership is Western Construction Company.

II.

That the character of the business is general contracting.

III.

That the location of the principal place of business and office is in the Arctic Building, City of Seattle, County of King, and State of Washington.

IV.

That the name and residence of each member, general and limited partners being respectively designated, is as follows:

(Testimony of J. A. Johnson.)

Petitioner's Exhibit No. 3—(Continued)

General Partners:

J. A. Johnson, 1619 East 52nd Street, City of Seattle, County of King, State of Washington.
George Johnson, 4558 55th N.E., City of Seattle, County of King, State of Washington.
Albin Johnson, 2003 Boylston North, City of Seattle, County of King, State of Washington.

Limited Partners:

Roy W. Johnson, 1520 Olin Place, City of Seattle, County of King, State of Washington.
Lloyd W. Johnson, 3679 Grayson Street, City of Seattle, County of King, State of Washington.

Winston A. Johnson, 901 East 71st Street, City of Seattle, County of King, State of Washington.

Eleanor J. Rector, 221 North Portage Path, City of Akron, County of Summit, State of Ohio.

Evelyn L. Jorgens, N. 603 Walnut Road, City of Opportunity, County of Spokane, State of Washington.

Bernice K. Wallin, 7214 Lake Ridge Drive, City of Seattle, County of King, State of Washington.

Elsie Kiel, 1912 North 46th, City of Seattle, County of King, State of Washington.

Vedola H. Johnson, 901 East 71st Street, City

(Testimony of J. A. Johnson.)

Petitioner's Exhibit No. 3—(Continued)

of Seattle, County of King, State of Washington.

Lorraine J. Ellingson, 1120 15th Avenue, City of Seattle, County of King, State of Washington.

Rachel Gustafson, 3219 Magnolia Boulevard, City of Seattle, County of King, State of Washington.

V.

That the term for which the partnership shall exist is for ten (10) years from the date hereof.

VI.

That the amount of cash contributed by each Limited Partner is as follows: Lloyd W. Johnson, Bernice K. Wallin, Lorraine J. Ellingson, and Rachel Gustafson, $5,000.00 each; all of the of the rest of the other Limited Partners the sum of $6,666.66 each.

VII.

That the time when the contribution of each Limited Partner is to be returned is agreed to be the end of said partnership as above stated, to wit: ten (10) years from the date hereof.

VIII.

The share of proceeds by way of income which each Limited Partner shall receive by reason of his contribution, is as follows:

(Testimony of J. A. Johnson.)

Petitioner's Exhibit No. 3—(Continued)

The General Partners, and each of them, are to receive a salary per year, to be fixed by them in a reasonable amount to cover their superintendence and management of the work and business, in proportion to the amount of work done by them, each year, taking into account the amount of the net profit of the partnership each year, never to exceed the sum of $15,000.00 a year salary to any one of the General Partners.

After the payment of said salaries to said General Partners and deduction of all other expenses of the partnership, the net income or proceeds shall be divided among the partners both general and limited on the basis of their financial interest in said partnership, as shown by the books of the partnership.

IX.

The General Partners are hereby given the right to admit additional Limited Partners in the future upon the agreement of the General Partners hereto, but in no event other than upon a cash contribution to the partnership, and upon the same terms as herein expressed.

X.

The entire management of the partnership shall be vested in the three General Partners and the right is hereby given to the remaining General Partners to continue the business upon the death or retirement of a General Partner, and the right

(Testimony of J. A. Johnson.)

Petitioner's Exhibit No. 3—(Continued)

is also given to the General Partners to continue the business upon the death or retirement of any of the Limited Partners hereto.

XI.

It is understood and agreed between all of the partners that a Limited Partner shall not receive out of partnership property any part of his contribution until all liabilities to the General Partners and Limited Partners on account of their contribution have been paid or their remains property of the partnership sufficient to pay them.

XII.

The interests of all the Limited Partners herein may be transferred upon the approval of the General Partners to accept a new assignee as a Limited Partner in this co-partnership, and not otherwise.

XIII.

No General Partners shall demand or receive any property other than cash in return for his contribution and each General Partner's interest in this partnership shall be fixed as of June 30, 1943, as per agreement of the General Partners and by the books of the co-partnership.

In Witness Whereof the partners have hereunto set their hands this 30th day of June, 1943.

/s/ ELEANOR J. RECTOR,
/s/ EVELYN L. JORGENS,

(Testimony of J. A. Johnson.)

Petitioner's Exhibit No. 3—(Continued)

/s/ BERNICE K. WALLIN,
/s/ ELSIE KEIL,
/s/ VEDOLA JOHNSON,
/s/ LORRAINE J. ELLINGSON,
/s/ RACHEL GUSTAFSON,
/s/ J. A. JOHNSON,
/s/ GEO. JOHNSON,
/s/ ALBIN JOHNSON,
/s/ ROY W. JOHNSON,
/s/ LLOYD W. JOHNSON,
/s/ WINSTON A. JOHNSON.

State of Washington,
County of King—ss.

On this 30th day of June, 1943, before me, the undersigned, a Notary Public in and for the State of Washington, duly commissioned and sworn, personally appeared J. A. Johnson, George Johnson, and Albin Johnson, the General Partners above named, and Roy W. Johnson, Lloyd W. Johnson, Winston A. Johnson, Eleanor J. Rector, Evelyn J. Jorgens, Bernice K. Wallin, Elsie Kiel, Vedola Johnson, Lorraine J. Ellingson, and Rachel Gustafson, Limited Partners, all of whom executed the foregoing instrument, and each one of said partners both general and limited, being sworn by me separately deposes and said that he or she as the case might be, had executed the foregoing instrument as his or her free and voluntary act and believed that the statements contained in said certificate of

(Testimony of J. A. Johnson.)

Petitioner's Exhibit No. 3—(Continued)

limited partnership are true, and that each one of them executed said certificate for the uses and purposes therein mentioned.

Witness my hand and official seal this 30th day of June, 1943.

[Seal] /s/ RALPH B. POTTS,
Notary Public in and for the State of Washington,
Residing at Seattle.

[Stamped]: Recorded July 2, 1943, King County, Washington.

State of Washington,
County of King—ss.

I, Robert A. Morris, Auditor of King County, State of Washington, and ex-officio Recorder of Deeds, and the legal keeper of the records hereinafter mentioned, in and for said County, do hereby certify the above and foregoing to be a true and correct copy of a Certificate of Formation of a Limited Partnership, Vault File No. 60514.

As of record in Records of King County.

Witness my hand and official seal this 10th day of May, 1948.

[Seal] ROBERT A. MORRIS,
Auditor of King County,
Washington.

By /s/ J. NACHTSHEIM,
Deputy.

Admitted May 24, 1948.

(Testimony of J. A. Johnson.)

Q. (By Mr. Potts): In the second limited partnership, was there any change with respect to any of your children? A. No.

Q. What was the difference in the two limited partnerships?

A. The only change was in Alvin's and George's change that they added another partner in there, but it didn't change the general condition; it was the same amount of money put in there but we were very anxious to get Leonard Gustafson in with us.

Mr. Potts: I think then that we will take that part of the examination up with the other general partners and save a little time.

The Court: Very well. [67]

Q. (By Mr. Potts): Now, in the formation of these limited partnerships, what, if anything, was issued to the limited partners showing their interest in the partnership?

A. I guess the only thing we issued was the statement at the end of the year when the books were closed.

Q. Was there any evidence of ownership of any kind given to the limited partners?

A. None whatsoever.

Q. Were there meetings of any kind held with the limited partners with respect to the business of the partnership? A. Never had any meeting.

Q. Was there any delegation of authority by any of the limited partners to you or to any of the other general partners?

(Testimony of J. A. Johnson.)

A. No. As general partners we looked after the work. If one would take a job and look after it to completion, he would do that; and if a job was real large like it was at Bremerton two of us would go on the job, otherwise one would take on the job and another fellow another job and that was the way we worked it all the time.

Q. Now, with respect to the financial interest of the general partners and the limited partners, how was that divided? [68]

A. I think it was about five twelfths (5/12) to the limited partners and about seven-twelfths (7/12) to the general partners.

Q. And how was your bank account carried?

A. In the Western Construction Company.

Q. Whose signatures were required to sign checks or notes?

A. We three general partners had to sign the checks, notes, and the checks, we had a right to sign, each one of us could sign checks.

Q. Would that be any one of the three signatures of the general partners on the checks?

A. Yes.

Q. Was your resolution changed after the formation of the limited partnership in that respect?

A. No.

Q. I mean the resolution at the bank?

A. No; the same thing.

Q. I say resolution—statement, or whatever it was at the bank?

A. No; there was no change at the bank.

(Testimony of J. A. Johnson.)

Q. Was there any board of trustees or directors or any so-called board of any kind set up in either of these limited partnerships? A. No. [69]

Q. Was there anyone that had the designation of president or secretary or treasurer?

A. No.

Q. No? A. No.

Mr. Payne: Now, if your Honor please, I object to that. The instruments are in evidence and we rely upon that and I object to this.

The Court: I will overrule the objection.

Mr. Payne: Very well; note an exception, please.

Mr. Potts: May I have just a minute, please?

The Court: Yes.

Q. (By Mr. Potts): Were there any minutes of any meetings ever kept by anyone in the partnership?

A. No meetings and no minutes.

Q. Were the notes paid before the end of the year 1945; any of the notes you have?

A. I am not sure now. I got the cancelled checks there. I don't remember now when they were paid. Some of those notes were paid but I can't say what time they were paid.

Q. With respect to the earnings of the limited partnership, will you tell the court whether or not there was any restriction of any kind upon the limited partners to withdraw, if the limited partner chose so to do, any earned income [70] on his investment?

(Testimony of J. A. Johnson.)

A. No. He could withdraw whatever was there.

Q. Was, in any way, any sum withdrawn or taken by a limited partner ever returned to you as general partner, as father?

A. Never. I know that Roy had drawn out even the capital, but he replaced what he had drawn more than he had coming.

Q. Let me see if I understand that.

A. Roy once drew out a little more than he had coming; he drew a check more than what was actually coming to him; but he paid that back by the way when he understood he had drawn more than he had coming.

Q. Did any of the limited partners, to your knowledge, draw money for anything they saw fit, personal expenses and so forth?

A. They all drew more or less a little now and then.

Q. Were any of these limited partners that you have referred to, or if you know any of them, not you, paid by any of the other general partners money for dependence; both fathers for support prior to the formation of either of these limited partnerships?

A. No; they were all able to take care of themselves.

Q. There were not, any of them, after the formation of either of these partnerships financially dependent upon either [71] you or any of the other general partners? A. No.

Mr. Potts: Your witness.

(Testimony of J. A. Johnson.)

Cross-Examination

By Mr. Payne:

Q. Mr. Johnson, I was not clear on the testimony you gave about the formation of the Western Construction Company, Incorporated, in 1935. I believe you stated that you and George and Alvin were the incorporators; was that right?

A. I was mistaken there; it was Roy and Lloyd and Mrs. Potts, the secretary.

Q. They were the incorporators? A. Yes.

Q. Why was that?

A. Because we did that in order to protect our financial interest until we had a chance to make enough money to pay off the indebtedness we had.

Q. In other words, you were deeply in debt as a partnership at that time? A. Yes.

Q. And you used those names to avoid using your own names? A. Correct.

Q. And was the stock issued to those three?

A. Yes. [72]

Q. Did the stock belong to those three or you brothers? A. It actually belonged to us.

Q. How old was Roy at that time in 1935? Do you know what year Roy was born?

A. I think he was born in 1910; I think that is correct.

Q. Is that correct? A. Yes.

Q. Just give the date; will you?

A. I think it is——

Q. All right; we will forget it.

(Testimony of J. A. Johnson.)

A. February.

Q. February, 1910?

A. My wife knows better than I do.

Q. So he would be about twenty years old in 1935; or twenty-five (25) years old. How old was Lloyd at that time, do you know?

A. He is seven months younger.

Q. Now, how long did that continue with the stock in the names of the three you have mentioned?

A. About five years.

Q. And then what happened? What changes were made?

A. Then we dissolved the corporation and the stock—what little earnings—went back to the three general partners again. [73]

Q. In other words, you left the stock in the names of the three right up until the dissolution?

A. Yes.

Q. But you say that the stock always belonged to you and to George and to Alvin; is that correct?

A. Yes.

Q. In equal proportions?

A. I believe it did; I am not absolutely certain.

Q. I show you a document, Mr. Johnson, and ask you if you recognize that? A. Yes.

Q. What is it, please?

A. That is an income tax statement on the corporation, isn't it?

Q. For what year? A. 1942.

Q. Was that the final return, do you know, of the corporation? A. I would think that it was.

(Testimony of J. A. Johnson.)

Q. And I show you exhibits attached to that and ask you if that does not purport to be the resolution voluntarily dissolving that corporation?

A. I believe that is what it is.

Q. And that shows the stock as belonging to you and to George and to Alvin in equal proportions, does it not? [74] A. Yes.

Q. And those are your signatures?

A. That is mine.

Q. Yours and George's and Alvin's to that document? A. Yes.

Q. And you were appointed trustee in dissolution of the corporation? A. Yes.

Q. You were? A. Yes.

Mr. Payne: May that document be marked for identification as Respondent's Exhibit A, please?

The Court: It will be marked.

Mr. Potts: We have no objection to its introduction.

The Court: Respondent's Exhibit A, do you want to offer it at this time, Mr. Payne?

Mr. Payne: I think so. There are two or three papers on that that don't belong, but we will arrange to have those detached. We will offer it, then.

The Court: All right; Respondent's Exhibit A is received.

(The document referred to was marked Respondent's Exhibit A, for identification, and was admitted in evidence as Respondent's Exhibit A.)

(Testimony of J. A. Johnson.)

Mr. Payne: Merely to show that the stock [75] belonged, to these three individuals rather than to those Mr. Johnson states was the holders.

The Court: Yes; that is my understanding of the witness' testimony.

Q. (By Mr. Payne): Now, Mr. Johnson, the corporation had been active up until 1942, hadn't it?

A. Yes.

Q. And did a good deal of construction work?

A. We did a few jobs. We were able to take enough and make enough money in that corporation to pay all the indebtedness in the Western Construction Company partnership.

Q. Now, beginning with the end of 1940, through 1941, and up to 1942, you and Alvin devoted yourselves pretty much to the partnership work, didn't you? A. All three of us did.

Q. Did George devote himself pretty much to the corporation?

A. It just happened to be on that job that was under the corporation that——

Q. Anyway, the corporation was directed by all three of you and the partnership directed by all three of you the same way? A. Correct.

Q. Was there substantial equipment and profits in the [76] corporation in 1942?

A. We didn't have much equipment in the corporation to amount to anything.

Q. What about the business connections you had in the corporation at that time?

(Testimony of J. A. Johnson.)

A. Well, that was the business connections we had; what we had along with us from years past.

Q. And when you dissolved you took over the equipment and the business and unfinished matter into the partnership, is that correct?

A. Correct.

Q. And continued it in the name of the partnership? A. That is it.

Q. That all happened in 1942? A. Yes.

Q. What was the reason for the dissolution of the corporation?

A. We always worked more or less as a family partnership in almost thirty-nine years, you might say, and we could go farther in getting our bonds and finances in the partnership than we could in the corporation because in a corporation you are only liable for what you have in it, but in a corporation you make yourself liable for everything you have got.

Q. You mean partnership? [77]

A. I meant partnership; yes.

Q. Did you ever discuss with your tax counsel or attorneys about the tax liabilities of corporations beginning about 1942, the excess profits tax?

A. No; I don't remember that.

Q. You don't remember? A. No.

Q. Were you told it would be cheaper for you forming a partnership than a corporation from a tax point of view? A. No; I don't believe so.

Q. Who was representing you at that time in your tax matters?

(Testimony of J. A. Johnson.)

A. Why we had an accountant taking and make up our statement but I don't know that we had any particular representative.

Q. Then it is your testimony that you dissolved the corporation in order to get the business back in the Johnson family? A. Yes.

Q. Now, you stated that you had some difficulty in getting finances as a partnership; was that your testimony? A. Yes.

Q. Trying to get capital? A. Yes.

Q. You did borrow capital in 1941, didn't you, and in [78] 1940, also, from the bank?

A. All we could get.

Q. As a partnership? A. Yes.

Q. Sizeable amounts in connection with the Bremerton construction job? A. Yes.

Q. And you borrowed that on the names of yourself, and George, and Alvin? A. Yes.

Q. And Mr. Erickson; who was he?

A. My brother-in-law.

Q. And was he the owner of the West Coast Construction Company? A. Correct.

Q. And that was in the Bremerton construction work? A. Yes.

Q. That is the so-called West Park job?

A. That is it.

Q. And you made substantial profit on that work, didn't you?

A. We made pretty good there; yes.

Q. After that you were able to get your finances a little easier, weren't you?

(Testimony of J. A. Johnson.)

A. Yes; in a way, and in a way, not; because the money [79] that we made at West Park, we couldn't get out for over two years; two and a half years before we got the final out.

Q. You weren't having any serious difficulty in getting money?

A. It wasn't easy because as long as you didn't have the money in the bank, you couldn't—as long as you didn't have it under your own lock and key, you don't know whether you have got it or not.

Q. What was the nature of your work, Government contracts largely, wasn't it? A. Yes.

Q. And the government paid you periodically as the work was completed?

A. It was supposed to; yes.

Q. Well, you got substantially that treatment?

A. We got our monthly payments pretty fair, but the housing authorities at Bremerton, they were willing to pay us but the housing authority in Washington held up the payment and it went so far that the housing authority at Bremerton passed a resolution criticizing the Washington authorities very sharply for not paying us because we had earned it and were entitled to it, but it took six months after that resolution before we got final payment.

Q. Well, now——

A. When you take a contract, even subcontracting, you [80] won't get the money until you get it from the government and the government was so slow in paying their payments that even the sub-

(Testimony of J. A. Johnson.)

contractors refused to sign a contract of that kind due to the slowness of the government to pay the bills.

Q. What was the practice of the partnership; to take a copy of the government contract and file it with the bank and show the bank the payments due to you upon completion of the work and then get the bank to advance you money on that basis?

A. That is only done——

Q. You did follow that method?

A. We had to do that; but even then it was a question that you couldn't understand why you had to wait so long.

Q. All right; now, when you took the notes from these children in 1942, what did you do with them?

A. I guess they were kept in our office.

Q. They were kept in the office?

A. Yes; in the safe.

Q. You didn't ever pledge them with the bank?

A. I am not sure about that whether we ever took them down to the bank or no.

Q. You don't remember that you did?

A. No; I do not. I would have to refresh my mind about that; I don't believe we did.

Q. Did you say that you made some use of them in connection with the bonds? [81] A. Yes.

Q. How?

A. We put them on our statement.

Q. How was that?

(Testimony of J. A. Johnson.)

A. We showed them on our statement.

Q. How did you show them?

A. Notes receivable.

Q. Did the bonding company ever inquire into the nature of the notes?

A. I think they did.

Q. Did you have any discussion with them about it? A. Yes.

Q. What was the nature of the discussion?

A. I explained who they were from; who those notes were from.

Q. Did they ever look into the financial ability of the children?

A. No; but if he could get notes from about ten or twelve young people, particularly young people, married and had their home, he would know that if one wasn't good—he would rather take a note from ten than he would from one. I know they knew all of them would be good.

Q. Did you tell the bonding company that they were your children? A. Sure. [82]

Q. Then what did they say about it?

A. I don't remember the discussion exactly word for word, but——

Q. Did they question whether they were good or not for your purpose?

A. Not in my presence anyway.

Q. Did they out of your presence?

A. That I don't know.

Q. Did they question it to George, or Alvin, do you know? A. That I don't know.

(Testimony of J. A. Johnson.)

Q. Did you have any difficulty in getting your bonds allowed?

A. No. We didn't have real difficulty, but we were stretching our finances just as far as we could. If we had had more finances and could have taken larger jobs, there was better chance to make money on the larger jobs than the smaller jobs.

Q. Now, these notes in evidence, which you have identified and are in evidence as Petitioner's Exhibit 2, were one year notes from April 21, 1942, weren't they? A. Yes.

Q. What about after that note was due and unpaid, did you still use them on your financial statement?

A. Yes; they were good for six years after [83] that.

Q. I just wanted to know how you treated them. So that you took that note and used it for whatever purpose you could? A. Yes.

Q. But you never put it with the bank?

A. No.

Q. Did the bonding company ever look at the notes do you know?

A. I don't remember that they ever looked at the notes; it was explained to them what they were.

Q. Did they express doubt as to their validity because they were your children? A. No.

Q. Now, Mr. Johnson, you gave some testimony about the children. You don't happen to know of your own knowledge what Mrs. Rector's financial position was in 1942, do you?

(Testimony of J. A. Johnson.)

A. Yes. I did have a statement but I think the counsel has it now, the approximate statement.

Mr. Potts: Would you like to have that?

Q. (By Mr. Payne): When did she get out of school?

A. What year was it that England got in the war, if I may ask you?

Q. Was she out of school before 1942?

A. Yes. [84]

Q. How long before?

A. She just came back from England that time and went into business right after the war with England started.

Q. And what was her husband's profession?

A. He was a doctor also.

Q. You don't know how much your daughter owned in her own right separate from her husband, do you? A. No.

Q. Let me ask you this; did you ask her husband to sign that note, too?

A. No; I don't believe I asked him to sign it.

Q. Any discussion about it in the family?

A. Yes; it was discussed in the family.

Q. And what was the discussion?

A. And he had no objection to her signing the note and coming into the partnership.

Q. But he didn't indicate any willingness to sign it? A. We didn't ask him.

Q. Don't you think that it might be that the property owned, the home and so on, was her husband's and not hers?

(Testimony of J. A. Johnson.)

A. They were buying it together, of course.

Q. You don't know whether Ohio is a community property state or not, do you?

A. No; but I think she had more than he had, as far as that is concerned. [85]

Q. But you don't know what that is?

A. Well, she had her office and equipment and business.

Q. Did she own the office or rent it?

A. Rented it.

Q. How about the equipment?

A. That she owned.

Q. You don't know how much it was?

A. No; I don't remember now.

Q. Do you know whether it was paid for or was she still paying? A. It was paid for.

Q. All right. As a matter of fact, you don't know a great deal about her financial position at that time, do you?

A. I would have to refresh my mind to be able to give it to you. She said in a letter that she had——

Q. Let me ask you, did you make the inquiries about her financial condition before or after she gave the note?

A. I made inquiry at that time and also made inquiries about it now, what her financial status was.

Q. What inquiries did you make at that time?

A. How much business did she have.

Q. What did she tell you?

(Testimony of J. A. Johnson.)

A. From fifteen to twenty patients a week.

Q. From fifteen to twenty patients a week?

A. A week. When she first started. [86]

Q. I see. So her resources were her potential ability to earn, is that it?

A. And now she has fifteen to thirty a day.

Q. But your real inquiry has been made since this tax case came up for determination?

A. Yes, I admit that.

Q. Now, what about the Jorgens family in Spokane; you say he was a pressman?

A. Yes.

Q. How much did you say he received?

A. I don't remember that off hand, how much he was getting, but pretty good wages.

Q. Was Mrs. Jorgens working? A. No.

Q. Did they have a family? A. Yes.

Q. How many children at that time?

A. Two at that time; no, one at that time.

Q. Did they own a house?

A. Yes; they owned a house.

Q. Paid for or on contract?

A. I think they owed a little money on it.

Q. And they owned some land in addition?

A. Yes.

Q. Paid for? [87]

A. That was given to them by his father, the land.

Q. How much?

A. Oh, I think it is about 200 by 300.

Q. Just a lot you mean?

(Testimony of J. A. Johnson.)

A. Yes, in the city.

Q. Was that given to them before or after the marriage?

A. At the time of the marriage and then they had some property out at the lake. I don't remember the lake, but in the country there.

Q. When were they married? How long before 1942, do you know?

A. Oh, they must have been married five or six years then.

Q. Well, now, was Mrs. Rector here when the partnership agreement was signed? A. No.

Q. Did you send it back to her for signature?

A. Yes.

Q. What about Mrs. Jorgens?

A. I am not sure whether she was here or sent to her too.

Q. How did the question of this new partnership come up in 1941 or 1942, Mr. Johnson?

A. Well, we wanted particularly to get the boys into the business with us. [88]

Q. Did you have a previous plan for that in 1941?

A. We had had a plan for that all the time that we would get them in but it looked like they were drifting away from us instead of coming in. There was other attractions and we wanted to try to get them in with us to help us.

Q. You had another plan in 1941 to get them in?

A. Yes, the three boys.

(Testimony of J. A. Johnson.)

Q. Why didn't that succeed?

A. It succeeded to a certain extent.

Q. What do you mean by that?

A. They were still with us, some of them.

Q. Isn't it a fact that the boys were unwilling to stay with you in 1941; they were unwilling to tie up to any arrangement?

A. No; they weren't unwilling. If they were, they wouldn't have signed the note.

Q. When did Lloyd go with Kuney of Spokane?

A. About 1941, I think.

Q. And assumed a partnership with Mr. Kuney?

A. Yes; I understood that at that time. It was for one particular purpose.

Q. But it ripened into a permanent relationship? A. Yes.

Q. Where is the Kuney activities, in Spokane or in Seattle, do you know? [89]

A. At that time he had his office in Spokane and also here in Seattle, but I believe now that they just have the office in Seattle, but I am not sure.

Q. I see. Well, now, did you have a discussion about this family arrangement with your tax counsel and with your lawyer?

A. Not with a tax counsel; when we made up this agreement, we took it up with our attorney, of course. Had it made up so that it would be legal.

Q. Who drew up the agreements for you.

A. Mr. Potts.

Q. What did you tell Mr. Potts that you wanted to take the children into the business?

(Testimony of J. A. Johnson.)

A. Yes, sir

Q. And did you discuss with him the methods you could use to do that? A. Yes.

Q. Did he discuss with you the details of what the children were to do? A. Yes.

Q. And you had an understanding that the girls wouldn't work for the partnership, didn't you?

A. We didn't consider the girls so much as we did the sons-in-law.

Q. Well, you didn't provide for the sons-in-law in the [90] agreement, did you?

A. No; we just had our children sign, but we were particularly after our sons-in-law, to get them into business.

Q. But you weren't successful in getting any of them? A. No; we didn't.

Q. You stated on direct examination that the purpose of the partnership was to use the children; will you tell the court what you meant by that? You mean to use the sons?

A. To use the sons and use the notes as financial backing.

Q. You mean the notes that you took from the children? A. Yes.

Q. When you say you wanted to use the children in the business, you meant just the sons?

A. Well, the girls had been working with us some time before too. Eleanor worked in the office a long time and so did Evelyn, up until the time she got married, and during the time that Eleanor

(Testimony of J. A. Johnson.)

was in school, why she worked in the office every summer.

Q. How long was that?

A. Oh, that was about over five or six years, probably, before that, on account of she went back to medical school.

Q. What about Evelyn Jorgens, how long before 1942 did she work for the partnership?

A. Oh, about four or five years, I guess. [91]

Q. In fact, none of them worked for the partnership in 1942 or later, did they?

A. My youngest daughter was working in the office at that time.

Q. But she is not involved in this?

A. She is not involved here.

Q. I see. And of the sons-in-law who did work for the partnership, the only one was Mr. Gustafson? A. Yes; I believe so.

Q. And what year was that that he came to work for the partnership?

A. 19—I think he worked for us in—'41.

Q. Nothing after that?

A. No; I don't believe so.

Q. Nothing after 1941? A. No.

The Court: We will recess now until 2:00 o'clock, p.m.

(Whereupon, at 12:30 o'clock, p.m., a recess was had until 2:00 o'clock, p.m., May 24, 1948.) [92]

Afternoon Session
2:00 o'Clock P.M., May 24, 1948

The Court: You may proceed, Mr. Payne.

Whereupon,

JOHN A. JOHNSON

a witness called on behalf of the Petitioners, having been previously sworn, resumed the stand for further exmaination.

Cross-Examination
(Continued)

By Mr. Payne:

Q. Mr. Johnson, at the close of the testimony before we adjourned, I believe you said that Mr. Gustafson did not work for the partnership at any time after 1941, is that right?

A. No, I do not believe that he actually worked for us, except he might have looked over some of the estimates and so on, but he never put in full time there.

Q. He went back into some other business, you say? A. Yes, sir.

Q. For himself? A. Yes, sir.

Q. Mr. Johnson, what contracts did the partnership have on February 24, 1942, at the time of the formation of this limited partnership? What contracts did the old partnership have at that time?

A. Well, it was just about the time, I think, that we [93] had the Holly Park Housing Project. I am not sure, but it was somewheres around in there. No, it was before we got that job.

(Testimony of J. A. Johnson.)

Q. When did you get this work—this housing project down toward Renton—the Renton-Rainier Project? A. That was later.

Q. I will ask you again what contracts you did have in February, 1942.

A. I think we had what they called the Rainier Vista Housing Project.

Q. Do you know the date that you signed that contract?

A. No, but it was that Fall—in the Fall some time.

Q. In the Fall of 1941? A. Yes, sir.

Q. So you would say that you signed that contract as partners before the formation of the new limited partnership?

A. I believe that that is correct.

Q. What other contract did you have?

A. I think that that was the only contract we had at that time.

Q. And how much of a job was that?

A. Well, that is something that I cannot remember now.

Q. Would it run into a million dollars, say?

A. I do not think it would run into a million, but probably close to a million. [94]

Q. I believe you said that the West Park Project at Bremerton had practically been completed.

A. Yes.

Q. How large was that job—how much of a job was it? A. I believe that was $1,800,000.

(Testimony of J. A. Johnson.)

Q. Then you had some supplementals on that, didn't you?

A. I think that that included the supplementals.

Q. In the neighborhood of $2,000,000?

A. Yes, sir

Q. Now, you had quite a bit of work in process then in February, didn't you?

A. I think that is the only job that we had.

Q. In the Rainier Vista? A. Yes, sir.

Q. And you borrowed sizable amounts of money, didn't you, in 1941, Mr. Johnson?

A. Yes, we did.

Q. What would you say that that amount or those amounts were—in excess of $100,000?

A I don't remember. I would have to look at the books before I could answer that, because I don't remember now just what we borrowed.

Q. It took quite a bit of capital to run those big jobs, didn't it? A. Yes, it did. [95]

Q. Now, getting back just a moment to these notes which you gave testimony about, what is your understanding of the situation at the time that the new partnership was created? Did you as a father of the children who came into that partnership give them any money? A. No.

Q. The partnership agreement which is in evidence—may I have that please, Mr. Clerk—I call your attention to Petitioner's Exhibit 1, which is the first limited partnership agreement, and I notice therein a statement of the capital accounts—para-

(Testimony of J. A. Johnson.)

graph 4 of that agreement—"That the amount of cash contributed by each limited partner is as follows:

"$10,000 by each limited partner, except Roy W. Johnson, Eleanor Rector, and Evelyn J. Jorgens, who contributed $6,666.66 each."

Now, how were those amounts contributed? Can you clarify that for the record?

A. I think that this was the idea, that we had $10,000 in there—I am not sure that I have got this correct myself now—and that each limited partner had $6,666.66. Is that what that indicates?

Q. Well, I am just asking you. How did the limited partners contribute their share?

A. By money. [96]

Q. Was an amount set up on the partnership books for the limited partners? A. Yes, sir.

Q. And that amount then was taken out of the interest which you formerly had, is that right?

A. They gave me a note for the interest of $6,666, which would swell our capital by that note. note.

Q. That is what you say?

A. I think that that is clear, isn't it?

Q. Then what did you do—you had to set over to them a credit on your books for that amount, didn't you?

A. I am not a bookkeeper, so I don't know exactly how you set it up on the books.

Q. You don't know then?

A. But naturally they were credited with

(Testimony of J. A. Johnson.)

$6,666.66, because they put that in—even if they didn't put it in in cash they put it in by a note.

Q. And by doing that how would the partnership be richer after than they were before?

A. Well, we had $60,000 of notes in the partnership, and those notes were good.

Q. But those notes offset equal amounts which you credited to the individual limited partners, didn't they?

A. Well, we were just $60,000.00 better off after we had those notes than we were before. Even though it was not actually [97] in cash, it was in notes, but we were $60,000.00 better off financially than we were before.

Q. You mean that you were better off or the partnership was? A. The partnership was.

Q. But the notes were given to you individually, weren't they?

A. Yes, but when we signed for bonds and had a note in the bank—we were not in a corporation you see, we were in a partnership, and when we signed on the dotted line, we signed everything away that we had.

Q. When you agreed to give your children some share of that for their notes, you took the same personally for what you gave them, isn't that correct? A. Well, we still had the same capital.

Q. Now, what do you mean by that?

A. Well, I didn't pay them the cash. They owed me that $6,666 on a note, and I still had the same amount of capital that I had before.

(Testimony of J. A. Johnson.)

Q. But they owed you that note personally. They didn't owe it to the partnership—your children didn't owe it to the partnership, did they?

A. They owed it to me personally, but I had to sign for the company. We were $60,000.00 better off on account of those notes. [98]

Q. You mean you were, or the partnership?

A. The partnership.

Q. How was the partnership any better off? That is what I want to know.

A. We were $60,000 better off.

Q. The notes didn't belong to the partnership.

A. Yes, but——

Q. (Interposing): Now, wait a minute. You say "Yes," but do you mean yes or no? The notes were yours, or were they the partnership's?

A. The notes belonged to me personally because I had borrowed the money personally, but when we came to get a loan, or for our financial purposes, it didn't make any difference whether it belonged to the partnership or whether it belonged to me personally. As a partnership we had to sign on the dotted line, on the notes, or on the bonds, or on any finances that we had to get, we had to sign for it, and we obligated all our capital or all our belongings together when we signed the note.

Q. You mean you, George and Albin did.

A. Yes, sir.

Q. And that was so because you were general partners, isn't that right? A. Yes, sir.

(Testimony of J. A. Johnson.)

Q. So when you went to get credit you used all your [99] personal assets and resources in order to get it? A. That is correct.

Q. That is how you used the notes?

A. Yes, sir, that is correct.

Q. To get credit? A. Yes, sir.

Q. But you testified that you did not put the notes up with the bank. You said you just used them for the purpose of your satisfaction bond?

A. I don't know that we ever put them up to the bank.

Q. Do you know what the amount of your stated partnership interest was just before the formation of this limited partnership? A. No, I don't.

Q. Now, you gave some testimony about Lloyd going with Kuney, and you said that that was in 1941, according to your recollection.

A. Yes, I believe so.

Q. And you said that he did some work for the Western Construction Company. A. Yes.

Q. Did he do any after the formation of the new partnership?

A. Yes. That was just about the time when we needed him the worst. [100]

Q. All right. What did he do, and when?

A. Mostly estimating.

Q. Wasn't Lloyd pretty busy with the new job that he had?

A. Yes, but he could always spare an evening or an afternoon, or some time, because when it came

(Testimony of J. A. Johnson.)

to put over estimates and pricing things, if this had been in 1929 you had pretty near a good guide to go by. But now things were going up so fast that you had to compare notes and counsel in order to be able to determine what things were costing today. It was not what it cost yesterday, or last month, or last year, but what it cost today, on account of things changing so fast.

Q. Didn't Lloyd go to Spokane when he got that new connection?

A. Why, he was in Spokane, back and forth, I believe, but I think he was here in Seattle the biggest part of the time.

Q. Tell me when he did the first work for you in 1942, and what it was.

A. Why, he was in probably two or three times a week, and sometimes oftener in our office. I cannot say just when he did the work, or just what job he actually was helping us with, because we were figuring on work every day, and every week we were turning in some bid. [101]

Q. Tell the Court whether he just talked to you in the office, or did he go out and look at the jobs.

A. Well, it was not so much going out and looking at the jobs as it was to look over and try to price the quantities after the quantities were taken off, to determine how much it would cost to do the work.

Q. Can you tell me how much time he spent in your office in 1942?

A. No, I cannot say how much time he spent in our office in 1942 because——

(Testimony of J. A. Johnson.)

Q. (Interposing): Well, then, you cannot give the Court some reasonable idea of that, can you?

A. I cannot say how much time he spent. But to get a man in that knew something, who was willing to give you the best knowledge he had on it, that was not easy. You had to get your own relatives that were interested in it with you. You could not call in any other man and have him give you that information. You had to call on your own relatives to get that information and get that counsel.

Q. You think that he might have done that for you because you were his father?

A. Why, naturally it was in his own interest.

Q. I didn't ask you that. But entirely aside from any partnership relationship, don't you think that he might have been willing to give that to you or to one of the other boys [102] if you asked him?

A. Why naturally, when you have an interest in it, and you were naturally vitally interested in it, you would be willing to spend a little extra time to see that we made money.

Q. You didn't pay Lloyd anything for anything that he did for you, did you?

A. No, we did not. I spend a lot of time that I don't get paid for either.

Q. Can you tell us how much time he spent for the Western Construction Company in 1942, 1943, 1944 and 1945—how much time he spent during those years on this work that you speak of?

A. Not any more than that I can tell you how much time my attorney spent on it. It was time that

(Testimony of J. A. Johnson.)

was vital to us, that he would come in and go over those estimates. How much time he actually spent, I don't know, because sometimes he would go over the bids with me, and sometimes he would go over them with Albin and George, and sometimes he would even go over them with my brother at home in the evening.

Q. But you cannot identify any jobs or any particular bids that he worked on, can you?

A. I say I know the jobs that we did have. We got the Holly Park job, and we got the Renton Housing Project, but we figured on other jobs. I would say that it was almost every week that we put in a bid on some job. We figured on lots of [103] work that we never got.

Q. Now, Winston, you say that he worked for the partnership right through the period.

A. Correct.

Q. And you stated that he was in the Army during the war years. Now, what years were those?

A. I am not certain when he came back. He came back in 1941.

Q. When did the war begin, do you remember?

A. In 1940. I think that he came back in 1941. He was in just a short time, I know.

Q. He came back before the war started then?

A. No.

Q. All right. You say that his education was that he had some engineering training?

A. He had three years at the University of Washington.

(Testimony of J. A. Johnson.)

Q. And what was he doing in 1942 for the partnership?

A. Mostly estimating and office work.

Q. What kind of office work?

A. Estimating and buying of material, and ordering the material, and watching that the material got to the job.

Q. Who did the estimating before the boys came with you?

A. Well, we did some estimating ourselves, and then we hired estimators.

Q. What kind of a job would Winston estimate? Would he [104] estimate on the taking of a large job or a large contract?

A. Yes. He worked on almost every job that we had. And we had another man there too, helping him, but they worked together.

Q. You mean estimating what the cost would be in determining whether you should take the contract?

A. Mostly taking off quantities off the plan.

Q. How is that?

A. Mostly taking off quantities off the plan and ordering materials.

Q. Do you know how much you paid Winston?

A. I think he was paid 80 some odd dollars a week—between $80 and $90 a week.

Q. How much did you pay your other estimator?

A. About the same thing.

Q. You stated that you got the notes for the purpose of using them in your business?

(Testimony of J. A. Johnson.)

A. Correct.

Q. How much were you paid for the money that you were borrowing?

A. Six per cent, I believe.

Q. You knew that you had made some sizable profits in 1941 in the partnership, didn't you?

A. Yes, sir.

Q. And you expected to make some in 1942 on the contract [105] that you then had in process, didn't you?

A. You never know what you are going to make. You don't know whether you are going to make it or lose it.

Q. But you naturally expected to make it?

A. Why naturally you hope to make something.

Q. Do you know how much profits were credited to the account of these prospective limited partners the first year—1942?

A. No, I have not got the figures.

Q. You know that it was a large amount, don't you?

A. Why, I don't know how much it was, but I know that we made some profits.

Q. Well, we will develop that. Roy didn't do any work for the partnership in 1942, did he, Mr. Johnson? A. Yes, he did.

Q. What kind of work did he do?

A. He did engineering work.

Q. Why didn't you pay him for that?

A. We did.

(Testimony of J. A. Johnson.)

Q. Do you have records on that?

A. I am pretty sure that we have.

Q. I show you a document, and I will ask you if you know what that is. (Handing document to witness.)

A. This is a partner return income—a partner income return for 1942. [106]

Q. I will ask you to examine the schedule attached thereto and refresh your memory about the amounts paid for time devoted to the business, and I call your attention to Roy Johnson's name on that schedule.

A. I thought that he was with us in 1942.

Q. The return doesn't show any payments to Roy, does it, that year?

A. You can hardly prove it by me, but you can by the books.

Mr. Payne: I will have this marked for identification as Respondent's Exhibit B, if your Honor please.

The Court: It will be identified as Respondent's Exhibit B.

(Document above referred to marked Respondent's Exhibit B for identification.)

Q. (By Mr. Payne): You just don't recall now what the situation was as to Roy in 1942?

Mr. Potts: May I look at that return?

The Court: Yes, you may.

Mr. Payne: Certainly. Handing document to Mr. Potts.)

(Testimony of J. A. Johnson.)

Q. (By Mr. Payne): And now, he went to Alaska in what year—1944, wasn't it? [107]

A. 1944, yes.

Q. And what time of the year—what month was it that he went to Alaska?

A. Oh, it was in the Spring, I believe.

Q. And he didn't work with you any more in that year or 1945, did he? A. No.

Q. How much did you pay Roy? Do you remember the scale or salary that he got?

A. No, I don't remember that.

Q. You paid him about the same schedule or scale that you did other men doing the same work, didn't you?

A. No. I think he was paid a little more.

Q. You think that you paid him a little more?

A. Yes.

Q. Why do you think that you paid him a little better?

A. Well, he had more experience. I know the job that Roy worked on, but I might be a little mistaken on the date or what time it was.

Q. Now, Mr. Johnson, you testified as to the partnership agreement which is before you as Petitioners' Exhibit 3, the one entered into in June of 1933. Why were the additional children taken in at that time?

A. Well, so far as I know the main reason for that was to get Leonard Gustafson in with us, so as to get more [108] capital, and by getting more fellows in there we would get more capital. It would

(Testimony of J. A. Johnson.)

not increase the capital, but we wanted more of the family in there because each one had some income.

Q. What do you mean by that? I don't understand you. You wanted the whole family in for what reason?

A. To have more income—to get better backing—the more fellows that we got in there.

Q. Did Gustafson come in there in 1943?

A. Yes.

Q. I thought you said that he was out and didn't come in with you; that he didn't work for you even in 1942.

A. No, he didn't work with us, but he came in with us on that note there.

Q. Do you have a note for Gustafson?

A. For Mrs. Gustafson.

Q. For Mrs. Gustafson?

A. I don't know which one signed the note—whether he or she signed the note, but it didn't make so much difference because it was a family partnership anyhow.

Q. But Gustafson didn't come to work for the partnership, did he? A. No, he never did.

Q. So what you mean is you did it to get another note, is that it? [109]

A. Well, we got another note, although it didn't increase the capital or anything, but he was making money. He was pretty well fixed even at that time.

Q. I asked you if he ever did sign a note, or if you know whether he did or not.

(Testimony of J. A. Johnson.)

A. No, I don't know for sure. I don't know if he ever signed it personally.

Q. Now, Rachel Gustafson is George's daughter?

A. Yes.

Q. I see. And you say that no additional money was received?

A. No additional money was received. There was additional notes but it was not any more money.

Q. In other words you did not bring any additional children in that year?

A. No, I did not.

Q. The other boys did? A. Yes, sir.

Q. They simply split off the amounts that the other children had been given and divided it among the new children coming in?

A. That is correct.

Q. Now, you testified that the three partners signed all checks. That was so before the new partnership was formed, wasn't it? [110]

A. Yes, sir.

Q. That is, you mean any one of the three could sign them?

A. Any one of the three could sign them, yes, sir.

Q. And there was no change in that afterwards?

A. No.

Q. Was your bank account changed at all?

A. No.

Q. And none of your records were changed?

A. No.

Q. What about the contracts you already had?

(Testimony of J. A. Johnson.)

Did you give notice to the people from whom you had contracted work that you had changed your partnership? A. No. It was not necessary.

Q. When you entered into new contracts after that there was no change from the previous operations, was there? A. No.

Q. You and George and Albin were the managers of the business, weren't you?

A. That is correct.

Q. You testified that you never had any formal meetings. A. No, we did not.

Q. But you did have meetings, didn't you, to discuss your problems in your office, and in your homes, and on the jobs? [111]

A. When we were figuring jobs, of course we naturally had to get together and use our best noodles.

Q. You didn't have any written record of what you decided then? A. No.

Q. You gave some testimony that you thought Roy had drawn out more than he had coming to him. I didn't understand that.

A. Yes, I understand that he drew out at one time more than he had coming.

Q. You mean when he went to Alaska?

A. Yes.

Q. Roy is your son? A. Yes.

Q. Did you discuss with him his need for money at that time? Did he ask you about it?

A. No, I don't think that he did. Not that I remember.

(Testimony of J. A. Johnson.)

Q. How did he get the money?

A. The bookkeeper knew that it was his money, and when he asked if he could have it, why it was given to him, but then they discovered afterwards that he was overdrawn and then he paid it back again.

Q. Who was the bookkeeper?

A. Mrs. Potts.

Q. Would she do that without talking to you ordinarily? [112]

A. Yes. This was a family partnership, and she knew that there was not any question about it. We helped each other out wherever we could.

Q. And knowing that he was your son, why she probably would expect you to take care of it if she did it, is that correct?

A. She knew it would be taken care of. Anyway she knew that Roy would take care of it himself, as far as that is concerned, which he did.

Q. Did he use it in his business?

A. He used it up there in Alaska.

Q. Did he ever give you a note or anything to take care of the amount that he took?

A. No, he did not. When it was discovered, he made out a check and paid it back.

Q. You stated that so far as you knew there were no restrictions on the limited partners drawing out their money. A. No.

Q. You didn't encourage them to draw it out, did you?

A. No, we didn't encourage them. If they didn't

(Testimony of J. A. Johnson.)

need it, why we didn't encourage them to draw it out. In fact, we didn't draw out any more ourselves than what we actually needed—the three partners.

Q. Did anything come up about these taxes that these children would go in the partnership? [113]

A. How do you mean?

Q. Did the question come up how they were going to pay the taxes on their share of the earnings under the partnership agreement?

A. Well, if they didn't make any money they wouldn't have to pay taxes, would they?

Q. I beg your pardon?

A. If they didn't make any money they would not need any money to pay taxes on, would they?

Q. Do you know where the tax returns were prepared? Were they prepared for them there in your office?

A. I think that they were. I think that they helped to prepare them.

Q. Did you arrange to pay the taxes directly for them in some cases?

A. I am not sure, but in some cases we might have.

Q. How about the returns of their husbands or wives that were not your children? Were they also prepared there in your office?

A. That I don't know.

Q. You don't remember? A. No.

Q. Now, just one or two other questions, Mr. Johnson. You stated that the children understood

(Testimony of J. A. Johnson.)

that if they signed these notes they might have to pay them in the case of failure, [114] is that correct? A. That is correct.

Q. Did they understand that that was the limit of the amount that they would be liable for under the arrangement? A. Yes, I think so.

Q. You didn't expect them to have to pay those notes, did you?

A. Well, it was hard to know offhand whether they would make anything, or whether we would lose. The contracting business is the biggest gambling business there is.

Q. But you have done pretty well at it, haven't you?

A. Well, I have done good and I have done bad.

Q. When you made substantial profits the first year, why didn't the children pay those notes to you, do you know?

A. I don't know really why they did not. As far as I know—as I said before neither one of us three general partners drew out any more than just what we needed, and it was left in the pot there altogether anyhow, and we didn't pay so much attention to it so long as the money was there.

Mr. Payne: That is all.

Redirect Examination

By Mr. Potts:

Q. Mr. Johnson, showing you the income tax return for 1942, marked as an exhibit by the Respondent—as Respondent's Exhibit B—you were

(Testimony of J. A. Johnson.)

questioned about Roy working. I direct [115] your attention to "Addresses and time devoted to business of above respectively," on the first page, and I will ask you to examine Roy Johnson's name in that regard. Is it there?

A. Roy Johnson is on there.

Q. What does it show?

A. It shows his home address, and so on.

Q. Well then over here it says, "Addresses and time devoted to business of above respectively," and what does it show with regard to the time that Roy Johnson spent in 1942?

A. It just says, "Part time" there.

Q. Part time? A. Yes, sir.

Mr. Potts: You wish to offer this, Mr. Payne, no doubt. If you do we have no objection to it. You had it marked for identification.

Mr. Payne: We will offer it in evidence.

The Court: It may be received as Respondent's Exhibit B.

(Document heretofore marked Respondent's Exhibit B for identification, received in evidence.)

Q. (By Mr. Potts): Now, Counsel asked you whether, with regard to any of your contracts, you notified the owner or the person with whom you were contracting of the change of your partnership. [116]

First of all, Madam Clerk, will you mark this for identification?

(Testimony of J. A. Johnson.)

(Document above referred to marked Petitioners' 4 for identification.)

Q. (By Mr. Potts): Showing you Petitioners' Exhibit 4 marked for identification, will you tell the Court what that is?

A. We just notified the Austin Company about that limited partnership. I didn't know that we had, but I notice here that we did, however.

Q. And this letter is what—an acknowledgment, is it? A. An acknowledgment, yes.

Q. And this is dated when?

A. This is dated September 22, 1943.

Mr. Potts: We offer that, if the Court please, in evidence.

Mr. Payne: This pertains to the second limited partnership?

Mr. Potts: That is right.

Mr. Payne: No objection.

The Court: It may be received in evidence as Petitioners' Exhibit No. 4.

(Document above referred to, heretofore marked Petitioners' Exhibit 4 for identification, received in evidence.) [117]

Q. (By Mr. Potts): Will you explain your relation to the Austin Company at that time?

A. They were the architects on the Boeing contract. They were architects and engineers down there.

(Testimony of J. A. Johnson.)

Q. Is that one of the contracts you have testified you were the successful bidder upon?

A. That was the cafeteria building and the food service building, where Roy was the foreman and the superintendent on the food service building.

Q. Now, with relation to the investment of your limited partners, and when I say, "Your limited partners," I mean Roy, Eleanor and Evelyn, you—Madam Clerk will you mark this for identification and then I will show it to Counsel?

(Document above referred to marked Petitioners' Exhibit 5 for identification.)

Mr. Potts: This is Petitioners' Exhibit No. 5, for identification, Counsel, and that is a copy prepared from this. (Indicating.)

Mr. Payne: What is its purport?

Mr. Potts: This is the deposit of the money for those notes.

Q. (By Mr. Potts): Showing you, Mr. Johnson, Petitioners' Exhibit No. 5 [118] marked for identification, that is a copy, is it not, of this particular deposit slip which is still in the book and which I am showing you?

A. Yes. This is the deposit slip of the money that was paid back to Western Construction Company by Roy Johnson, Eleanor and Evelyn Johnson, $20,000. That was paid the 28th of May, 1942.

Q. And in what amounts each?

A. $6,666.66 each.

(Testimony of J. A. Johnson.)

Mr. Potts: We offer the duplicate, if the Court please, in evidence.

The Court: You say that it was paid in 1942?

The Witness: Yes.

Mr. Payne: That is a surprise to me, your Honor. I did not know that, and I don't think that the witness did.

Mr. Potts: Well, he may have forgotten it.

The Witness: I had forgotten it also.

The Court: May 28th?

The Witness: Yes.

The Court: That is, it was deposited May 28, 1942, was it not?

The Witness: Yes.

The Court: All right. It will be received in evidence as Petitioners' Exhibit No. 5. [119]

(Document above referred to, heretofore marked Petitioners' Exhibit 5 for identification, received in evidence.)

Q. (By Mr. Potts): Now, I think, Mr. Johnson, you stated that you did not believe any of the sons-in-law worked for the company. Are you correct about that?

A. On refreshing my mind I know that Mr. Alexson——

Q. (Interposing): Alexson or Ellingson?

A. Ellingson—why, he worked for us ever since he came back from the Navy or from the Army. He worked for us right straight through.

Q. And whose husband is Mr. Ellingson?

(Testimony of J. A. Johnson.)

A. That is Betty Johnson's husband, or George's daughter's husband.

Q. And she is one of the limited partners?

A. Yes, sir.

Mr. Potts: Your witness.

Recross-Examination

By Mr. Payne:

Q. I show you Petitioners' Exhibit No. 5 and ask you when you first saw that.

A. Oh, I have seen that, but I forgot about it.

Q. Do you recall, or do you know where the money came from that went into that deposit? [120]

A. That I don't know. The bookkeeper would know that, but I don't know.

Q. Do you remember collecting interest from these children for the amount of their notes?

A. Yes, sir.

Q. For 1942? A. We got interest on that.

Q. Did you get the interest from them after 1942, do you know? A. No, I don't think so.

Q. You don't remember? A. No.

Q. Did they pay you this money or did this come out of the business, or what do you know about that?

A. That I don't know.

Q. You don't know anything more than it appears on these slips here?

A. I remember seeing it, but I have forgotten now exactly how it came about.

(Testimony of J. A. Johnson.)

Q. Do you know who wrote these names on here?

A. Mrs. Potts.

Q. Mrs. Potts?

A. Yes, sir. She depoisted it.

Q. And that is all you know about it?

A. Yes, sir. [121]

Q. When did Mr. Ellingson come back from the Navy?

A. I don't remember now. 1943 I would say.

Q. What kind of work was he doing?

A. Why, he was doing carpenter work, and then he was out chasing for materials—getting materials.

Q. Do you know how much you paid him?

A. No, I don't remember that. I don't remember how much he was paid, but he was paid the same as the rest of the fellows doing the same kind of work.

Q. Mr. Johnson, do you have available in the Court Room a record of your withdrawals in 1942?

A. My withdrawals?

Q. Yes. A. I don't know—is it?

Mr. Potts: Yes.

Q. (By Mr. Payne): Do you remember drawing money out of the partnership of about $20,000 on or about April, 1942?

A. I don't remember, but that is possible.

Q. You don't remember? A. No.

Mr. Payne: That is all.

Mr. Potts: That is all.

(Witness excused.) [122]

Mr. Potts: I will call Mr. Granston. I am calling him a little out of turn, but then he is a short witness. Is that agreeable, Mr. Payne?

Mr. Payne: That is all right.

Whereupon,

FRANK OSCAR GRANSTON

called as a witness for and on behalf of the Petitioners, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Potts:

Q. Will you state your name and address, Mr. Granston?

A. Frank Oscar Granston. I live at 4558 4th N. E., Seattle.

Q. Mr. Granston, what business are you engaged in?

A. I am in the plumbing and heating contracting business.

Q. How long have you been engaged in that business in this community? A. Since 1920.

Q. Mr. Granston, can you tell the Court whether or not some time in 1941 you had any conversation with either of the general partners of the Western Construction Company, George Johnson, J. A. Johnson or Albin Johnson, regarding that company? [123]

A. I have had conversations with both John and George Johnson, and there were several times they have asked me to go into ventures with them on

(Testimony of Frank Oscar Granston.)

contracts. They were short of money, and they wanted me to go along with them on different jobs, that I should put some of my money in and I would get a certain percentage of that contract.

Q. Directing your attention to 1941 can you tell the Court whether approximately in that year or some time near that year you had such a conversation with either George or J. A. Johnson?

A. I will go into more detail on that, if you wish me to.

Q. Yes, I wish you would do that.

A. In 1940 we actually did consummate a joint venture, and also even did bid on a job at Fort Lewis. That was not awarded to us. And then I know there were several times there in 1940 and 1941 where they asked me to go in, and I was busy with something else and I did not care to go into it, and so I told them, "No, I don't care to go in." But as far as the dates are concerned, I don't know what they would be, and I do not know what the jobs would be, but I knew that several times—it may have been more than several times, but I know that there have been several times that they have asked me if I would go along with them and put some money in with them on some of their projects. [124]

Q. Would you say that it was approximately during the period that I have mentioned?

A. It has been in 1940 and 1941.

Mr. Potts: Your witness.

Mr. Payne: No questions.

(Witness excused.)

Mr. Potts: I will call George Johnson.

Whereupon,

GEORGE JOHNSON

called as a witness for and on behalf of the Petitioners, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Potts:

Q. Will you state your full name and address?

A. George J. Johnson.

Q. Where do you reside?

A. 4560 55th Avenue N. E.

Q. In Seattle, Washington?

A. In Seattle, Washington.

Q. Mr. Johnson, how long have you been a resident of Seattle, Washington?

A. Since 1907.

Q. Where did you reside prior to 1907?

A. Winnipeg, Canada. [125]

Q. How long did you reside in Winnipeg?

A. About two years.

Q. And where did you reside before that?

A. In Sweden.

Q. Are you a citizen of the United States of America? A. Yes.

Q. Naturalized? A. Yes.

Q. In what district? A. In Seattle.

Q. In the Seattle district? A. Yes.

Q. Now, what business have you been engaged in during the period that you have recited to us?

(Testimony of George Johnson.)

A. Well, the first year or year and a half why I worked for others as foreman here in Seattle.

Q. You are referring to 1907, are you?

A. Yes.

Q. All right.

A. But then we started in a small contracting business here in Seattle, building small homes, and so forth, and gradually got into a little larger work, and so forth.

Q. Did you work alone? You said that you started building small homes, and then you got into larger work. Were you working alone? [126]

A. No. My first partner was Anderson. He stayed only a short while. And then J. A. Johnson came in with me, and from there on we have worked together. We called ourselves the Johnson Brothers for quite a few years. And then during the first world war why, on the advice of our bank, they said, "Why not change to something else and take another name?" and we took the name of the Western Construction Company, which we have maintained, you might say, since that time.

Q. That was you and J. A. Johnson, the gentleman who was the first witness for the Petitioners here?. A. Yes, sir.

Q. And did you take in any other partners prior to the formation of the limited partnership here in question?

A. Yes. In 1934 when we figured the Coulee Dam bridge piers, we took in Albin with us.

Q. Is Albin any relation to you and John?

(Testimony of George Johnson.)

A. He is a brother of ours.

Q. And what happened after that period of time, and after you formed the partnership with Albin?

A. Well, after we got started the three partners—when we got started as three partners why we then were battling building this Coulee Dam project—building under this Coulee Dam contract, which was a tough one. And as already testified to we lost just about everything that we had. Of course if we had liquidated at the time we would not [127] have been able to pay up the bills. But with the maneuvering of incorporating—the incorporation was held under Lloyd Johnson—I think he was named as president, and Roy and Miss Lucille Easterbrook, as she was then—we were able to start to make a little so that we could pay up our old debts, and we finally got a little bit on our way again to recovery. But it was a tough road. And we tried every which way we could to get a little safer so that we could commence to figure work in higher brackets.

Q. Just a minute. Let us fix the date. Do you recall about when the corporation was formed—about the date?

A. Well, the corporation was formed, I should say, in 1936. I am not quite sure on that date.

Q. Do you recall about when it was dissolved?

A. Well, there was no more work taken in under the corporation after 1940, but I do not think it was dissolved until some time in 1941.

(Testimony of George Johnson.)

Q. Now, you mentioned Lloyd, who is your son, is he not? A. Yes, sir.

Q. And Roy and Miss Easterbrook, who is Mrs. Potts at the present time. A. Yes, sir.

Q. And did they have the stock issued to them, or was the stock issued to someone else in this corporation?

A. Well, the stock—they were officers, but really the [128] stock belonged to the partners, as I understand it.

Q. I will ask you if the stock was ever transferred from their names prior to the dissolution—before the dissolution.

A. I think it was transferred from their names to the partnership's before it was——

Q. (Interposing): You mean then to yourself and J. A. Johnson and Albin?

A. That is right.

Q. Now, will you tell the Court the reasons you had for the formation of the limited partnership?

A. Well, we were constantly looking forward to being able to take the larger work. But before it was well to take a plan and start and figure, you had to contact people to see if they would furnish a bond in that amount, and most of the time we heard, "No." So we were not able to reach the goal or even start to figure on it. So we called in Philip Johnson of the Boeing Company, because we knew him pretty well. We had built his home, and after

(Testimony of George Johnson.)

considering it a little bit why he says, "No," he was going to use his money elsewhere, and we found out that he was not interested.

Q. I am not quite sure that I understand you. You called in Philip Johnson, you say?

A. Yes, sir.

Q. For what purpose? [129]

A. And asked him if he would be willing to put in $25,000 or $50,000 with us—if he would not invest some money with us.

Q. Are you referring now to the partnership?

A. Into the partnership—yes.

Q. All right.

A. But he answered us declining that request.

Q. Do you know where Mr. Johnson is now—Philip Johnson?

A. Mr. Johnson passed away a few years ago.

Q. Go ahead.

A. We then asked Clyde Phillips who was also at that time one of the bonds salesmen here in Seattle, if he would take some of his private money and put it in with us, because he was furnishing bonds for us. But he could not furnish the bonds for the jobs that we wished to figure on. Well, he of course would have put in money with us, but of course he would have wanted such a huge part of the partnership, so that we would have been working for him rather than for the Western Construction Company.

So then we saw Granston of the University Plumbing Company.

(Testimony of George Johnson.)

Q. The gentleman that just preceded you on the stand?

A. Who just testified, yes, sir. We have known him very well for many years. But, of course, he has a business [130] of his own, and of course naturally he wants to have enough money so that he can paddle his own canoe, and he might also have thought, "Well, it is not so sure to invest the money in general contracting because it is—you don't make money on every job you take. It is a risk."

Q. Well, did you succeed in getting any capital in? A. No, we did not.

Q. Any outside capital?

A. We did not succeed in getting any capital. And when we were about to figure the Bremerton job, we could not handle that, and that is why Clyde Phillips that I have just mentioned was contacted and he says, "I know of a contractor that is possible could go along with you," and he said, "This man that I have in mind is a man that you know very well, and he is worth around $60,000 anyhow." And finally he told us who that man was—he says, "Well, it is your own brother-in-law, Erickson of the West Coast Construction Company."

So we dropped in on Erickson, and we were led to believe that he was worth anyhow $60,000.

Clyde Phillips represented Erickson, which was the West Coast Construction Company, and he represented the Western Construction Company and

(Testimony of George Johnson.)

the West Coast Construction Company as a joint venture in his own office, and how he did it I don't know but we got the bond for the two companies, and it [131] was decided then that Erickson would have a 40 per cent interest in this Bremerton job and the Western Construction Company, a partnership, would have 60 per cent.

First, as we were called upon to put up some money in the bank for to get additional insurance or a bond for this Holly Park contract or, rather, the West Park contract——

Q. (Interposing): That is the Bremerton contract, is it?

A. That is the Bremerton contract, yes, why Erickson said, "Well, I cannot put in any money. I haven't got it." And he could not borrow it. So, when we called upon him to put up this extra money, we just had to shoulder that whole burden.

We figured that Erickson was worth $60,000, and we figured that he could carry his burden, 40 per cent, but after we were through we found out that we had to shoulder all of the burden, you might say, with the exception that he helped us in getting the surety bond. But otherwise we could have just as well had it without that.

Now, then, we had, you might say, exhausted all possibilities of any outsider to put in any money with us.

So we had talked of this idea of getting our own children to go with us to a certain extent and raise

(Testimony of George Johnson.)

the $60,000. We started from there, with the idea of raising $60,000 and planning on how this could be done—to raise the $60,000. In other words now we had the same amount of cash in the bank, [132] but we had $60,000 worth of notes that could be called upon any time if we should get in a tight spot. We had this $60,000 worth of notes, and if we got in a tight spot we could call upon this reserve.

Q. With regard to those notes, I will have them identified, but to whom were the notes made payable?

A. They were made payable to the general partners, to J. A. Johnson, George Johnson and Albin Johnson.

Q. And now, with respect to the first limited partnership, which of your children were taken into the partnership?

A. Lloyd Johnson and Bernice Wallin.

Q. Tell us about Lloyd. What has been his education and what was his age at the time that his note was taken?

A. Oh, I presume he was about 35.

Mr. Potts: One note is missing. We will try to find it by tomorrow morning.

The Court: Very well.

Mr. Potts: I think, if I may, to save confusion I will recall this witness to the stand later to identify these first notes then.

The Court: Very well.

(Testimony of George Johnson.)

Q. (By Mr. Potts): Will you tell us about those first notes—I mean the notes on the first partnership—the first limited partnership. What was their amount, do you remember? [133]

A. They were notes from Lloyd Johnson of $10,000, and likewise another from Mrs. Bernice Wallin of $10,000.

Q. Now, will you give us Lloyd's background, as to his education?

A. Well, Lloyd is a graduate engineer from the University of Washington, and during his high school years and also during his University years he always worked on one of our jobs every summer whenever he had a vacation.

Q. When did he first commence working for the Western Construction Company—at what age?

A. I think he was either 12 or 13—around there. The first job that he worked on was the Shafer Building on Sixth and Pine, and I think that he must have been either 12 or 13 at that time.

Q. All right.

A. And he worked on several jobs. He worked on the Courtright Creek Bridge up at Mount Rainier. He worked on the Bellingham Hotel. He worked on the University—when they built the addition to the pavilion over at the University of Washington. And he worked on the Puget Sound Bank Building.

Q. That is in Seattle?

A. Oh, yes, right here in Seattle. Well, I guess it would be—there was just about a different job for

(Testimony of George Johnson.)

every year that he worked on during his school years. And when he was through with school, why he worked for us over on that job [134] at Coulee Dam. His position there at Coulee Dam was—he done the engineering work there, and also done the bookkeeping on the job. There he was required also to engineer false work, and all the steel work and caison work had to be engineered, and drawings made and sent over to the engineers, for the purpose of having them approved. And that was a job that was quite a bit out of the ordinary. So it took a man that had real education in that line of business.

Q. After Coulee Dam what did Lloyd do?

A. Well, after Coulee Dam of course he was largely—whenever he worked, he worked in the office, until he was invited by—he went then with Kuney during this time that we were, you might say, unable to handle any work for a while—we we were so badly bent so that we were not quite sure that we ever would be able to take up contracting again. So he was invited then to go up to Montana and be assistant superintendent on their dam building there, and he asked——

Q. (Interposing): Is that the Fort Peck Dam?

A. That was Fort Peck. And he asked me after he was married what he should do, if we had an outlook to get some work, or should he take this opportunity up at Fort Peck. And he said, "'It will just be a short period, and by the time that

(Testimony of George Johnson.)

that job is through maybe you will have something, and you will get something started."

So when he actually was through there, why he came back [135] and worked with us again. But being that he got acquainted with Kuney, why Kuney came down to Seattle here and invited him then to come and figure a job with him, which he did. And after he figured this job I thought well, they may not get that work anyhow. So I was not too terribly worried, and I was not too terribly severe that he should not go in there. But they got the work that they figured on, and he got that started. And of course he worked then most of the time in Kuney's office. But as you have already heard here he has been interested in us, or with us in this partnership here, and whenever we have been in a position where we needed him, why he has always seen that he gives us time to estimate and work with us. I know several jobs that I can recall from memory that he helped us in estimating.

As you know, when you take out a plan to figure, why you cannot decide on how long you are going to have that plan. The engineer that checks figures decides for you when the figure is going to be in. And there is no use taking out a plan unless you can figure by that set hour. And therefore it is needless to explain to you that a man that has education can go through a set of figures faster than a couple of fellows that haven't got much education.

Q. Did Lloyd ever assist you after the formation

(Testimony of George Johnson.)

of the general partnership in any other way besides estimating and taking off quantities from plans, and so forth? [136]

A. Well, yes. Whenever we have needed a man we will say to be our spokesman—to mean a fellow that had education, and argue our points, why we always had a chance to call on him.

Q. What about getting materials?

A. Well, he has at times helped us in using his pry to get materials.

Q. What word is that that you just used?

A. I used the word, "pry." There was a time in contracting history that when you got a job, the material men would come to you and would be willing to sell you the material. But lately it is up to the contractor to go out and see where he can possibly buy it.

Q. Showing you that which I have had marked for identification of Petitioners' Exhibit 6—will you mark this, Madam Clerk?

(Document above referred to marked Petitioners' Exhibit 6 for identification.)

Q. (By Mr. Potts): Will you tell the Court what that is?

A. Well, this is a letter from Kuney & Johnson to us, telling that they have a quantity of nails held for us out at Peterson's Hardware.

Q. Where is that?

A. Peterson's Hardware is a wholesale [137] hardware establishment here in Seattle.

(Testimony of George Johnson.)

Q. Who did that? A. Lloyd Johnson.

Q. Were nails difficult to get during this period?

A. Oh, nails were just about impossible to get.

Mr. Potts: We offer Petitioner's Exhibit 6 for identification in evidence.

Mr. Payne: No objection.

The Court: It will be received as Petitioner's Exhibit 6.

(Document heretofore marked Petitioners' Exhibit 6 for identification received in evidence.)

Q. (By Mr. Potts): Now, Mr. Johnson, tell the Court with relation to Lloyd, whether or not he was involved in your intentions to start this limited partnership. Did he figure in your intentions?

A. Well, of course my idea was that, if I could, to get him interested in the partnership, and if I could get him interested in the parhnership that he would eventually come back and work for us all the time in our outfit. In other words, I never thought that it would get up to that, that he would absolutely start for good to work for Kuney. I thought that that was only going to be a temporary proposition. [138]

Q. What has been his success with Mr. Kuney?

A. Very good.

Q. Now, Mr. Johnson, did Lloyd have any interest in the Western Construction Company—the partnership—prior to the formation of the limited partnership? A. Yes.

(Testimony of George Johnson.)

Q. What was the nature of that interest?

A. Well, he was—he had an interest in the Western Construction Company, which was from his mother's estate. I lost my first wife, and although Richard, Lloyd and Bernice have never drawn that money, that was set aside by the Court for to be their share. And I was appointed guardian for the three children.

Mr. Potts: Will you mark this as Petitioners' Exhibit 7 for identification, Madam Clerk?

(Document above referred to marked Petitioners' Exhibit 7 for identification.)

Q. (By Mr. Potts): What was your wife's name? A. Amanda Katherina Johnson.

Q. Showing you Petitioners' Exhibit 7 marked for identification—I take it that you have seen that before—have you? A. Yes.

Q. Will you tell the Court what that is? [139]

A. Well, this is a photostat copy of the probate.

Q. I will ask you if it is not the decree of distribution? A. Yes.

Q. Or order of distribution, as it is called there?

A. Yes, sir.

Q. Of the estate of Amanda Katherina Johnson, deceased? A. That is right.

Q. What County or State was that probated in?

A. In King County, Seattle, Washington.

Q. Seattle is the seat of King County, is it not?

A. Yes, sir.

(Testimony of George Johnson.)

Q. Now, referring to page 2 of the exhibit, with reference to Western Construction Company, is there any decree of the Court in that respect?

A. Why, it sets aside a certain piece of property, which is like getting——

Q. (Interposing): No, I am not referring to the real estate. I am referring to the Western Construction Company. Let me direct your attention. I believe it is the last paragraph here on page 2.

A. Yes. It sets aside 275.48/3952.88 of the interest in the Western Construction Company; one-sixth interest in the first mortgage of Lot 6——

Q. (Interposing): Just as it concerns the Western [140] Construction Company.

A. All right.

Q. Does not the decree provide as follows: "To each of the three minor children, Rachel Doris, Lloyd Wallace and Bernice Katharina 275.48/-3952.88 of the interest in the Western Construction Company." A. Yes, sir that is correct.

Mr. Payne: As of what date?

Mr. Potts: I will ask him that.

Q. (By Mr. Potts): Will you give us the date of this decree?

A. It is dated the 15th day of September, 1921.

Q. And it is signed by what judge—by King Dykeman, is it not?

A. It is signed by King Dykeman.

Q. By the way, what were the ages of the three children at that time—at the time of this decree—approximately?

(Testimony of George Johnson.)

A. I presume Bernice was about 3 years old; Lloyd might have been about 8, and Rachel around 11 or 12.

Q. Was there a guardian appointed for the three children? A. Yes.

Q. Do you know who was appointed guardian?

A. I was appointed a guardian.

Q. You were appointed a guardian? [141]

A. Yes.

Q. Did you ever convey to the children this interest in the Western Construction Company?

A. No, it never was conveyed, because at the time that the children became of age, why we were very badly in need of every dollar that we could get our hands on, and I talked to the children about it, and they were willing to wait until later on.

Mr. Potts: We offer, if the Court please, this Petitioners' Exhibit 7 marked for identification in evidence.

Mr. Payne: If Your Honor please, I shall have to object to it on the ground that it is before the date when they said their partnership had terrible losses and they lost everything and had to form a corporation and start over again. I do not think it has any meaning or purpose in view of what has already been testified to. So I object to it.

The Court: Well, I do not know how much weight and value it will have as testimony, but in a case of this kind it is the usual practice of the Court to receive any testimony that the Petitioners

(Testimony of George Johnson.)

have of this sort, so I will overrule the objection.

Mr. Payne: All right.

(Document heretofore marked Petitioners' Exhibit 7 for identification, received in evidence.) [142]

Q. (By Mr. Potts): I think you have finished with your explanation about the guardianship. At the time that you took the two notes, one from Lloyd and one from Bernice, what were their approximate respective ages—that is, the notes for their interest, or for the money that they had invested in the limited partnership?

A. Well, Lloyd, I presume was around 35 and Bernice about 32, and Rachel, she must have been oh, about 39.

Q. Well, were Rachel and Bernice married at that time? A. Yes.

Q. With respect to Bernice, what was her financial condition at the time you took this note from her? A. Oh, pretty good.

Q. Well, can you give us anything a little more definite?

A. Well, I knew that they had a home that was worth maybe $12,000 or $15,000.

Q. What did Mr. Wallin do at that time?

A. At that time he was manager of the Safeway Store in Renton.

Q. Was that a large store or a small operation?

A. Quite a large store.

Q. Do you have any idea what income he had?

(Testimony of George Johnson.)

A. Well, of course he received a salary, but he also [143] had a percentage check each month. That I don't know for sure—what he did get altogether.

Q. Mr. Wallin will testify here himself, will he not? A. Yes.

Q. Would you place any value upon the partnership interest at that time of Bernice in the Western Construction Company—can you place any value upon that? I mean, her separate estate here as shown by that decree?

A. Well, of course I have never really figured up what that estate would amount to, but from my knowledge I would say that it was worth anywhere from $12,000 to $15,000 at that time.

Q. There was some real estate also set out in the decree in which there is a distributive interest, is there not? A. That is right.

Q. Now, Mr. Johnson, with the knowledge that you possess as trustee, or original executor, and then guardian, and then trustee of this share in their mother's estate, will you tell the Court why you took a note for their interest so that they could get funds to invest in the limited partnership?

A. Well, naturally, if we should swell our carrying capacity with the bond people, we had to have the notes, or have something tangible that could be relied on as an asset. If I had taken money out of the children's estate and put it [144] into the Western Construction Company, it would have been just like taking money out of one pocket and

(Testimony of George Johnson.)

putting it into another. But being that the children were willing to put up this note, it gave us $60,000 assets.

Q. Now, what about Rachel? In 1942 in this first partnership she did not have a partnership interest. Will you tell the Court the reason for that?

A. Well, at that time I asked Rachel whether she wanted to go with us, the same as the rest of them. But she was not quite sure—she was just a little reluctant, and, of course, we realized also that there was some liability attached to this here. So it was not all roses, and maybe she considered something about the Coulee Dam job, and I didn't blame her so much for sort of being a little hesitant——

Q. (Interposing): Well, she didn't come in.

A. She didn't come in.

Q. Now, what about Betty or Lorraine?

A. Lorraine——

Q. (Interposing): When did she come in?

A. She came in on the second—about the same time as Richard came in.

Q. Well, did you have any other children at that time? A. Yes, I then had another boy.

Q. What is his name?

A. His name is George Rodney. [145]

Q. What was his age in 1943.

A. Well, he is 19 now.

Q. He is attending the University, is he?

A. Yes, sir.

Q. Now, regarding Betty, what was her marital status at the time that the second limited partnership was formed? A. She was married.

(Testimony of George Johnson.)

Q. And who was her husband?

A. His name is Ellingson.

Q. And what was his occupation at that time—in 1943? A. Well, he was in the Marines.

Q. In the war? A. In the war.

Mr. Payne: I didn't hear that.

The Witness: He was in the Marines.

Q. (By Mr. Potts): What was their marital status, financially?

A. Well, he had inherited some money from his father's estate, and he had some money besides that.

Q. Do you know what his intentions were about the Western Construction Company?

A. Well——

Q. (Interposing): At that time, I mean.

Mr. Payne: If your Honor please, I object to what his intentions were. I do not object to what he may have said [146] or done.

The Court: Yes.

Mr. Potts: Yes. I think that that is hearsay.

Q. (By Mr. Potts): Did he work for Western Construction Company?

A. Well, as soon as he got back from the war, why he started immediately to work for us.

Q. And how long did he work for you?

A. He worked for us as long as we had work.

Q. How did Rachel and Betty achieve their interest in the second limited partnership?

A. Well, they achieved it in this way, that they prevailed upon their brother and sister that they

(Testimony of George Johnson.)

would let them in on this here now, and they figured out that it was all right. I had no objection, because it gave me perhaps a chance for Leonard Gustafson to come back into the business at that time.

Leonard Gustafson, when he first started to go with my daughter, why he was studying medicine, and I talked him out of that and told him, "Well, you have a much better field if you will take engineering, like Lloyd," and he finally changed from that career into engineering. But when he finally was through the University, why, that was right in the middle of the depression. During his time of going to the University he had spent most all of his Saturdays in a butcher shop, [147] working as a butcher. Now, he was wondering whether after he got through the University—whether he should try to get in with us, or should he continue with the butcher business. And we tried at all times to enlarge our capacity as far as finances went so that we could have gotten Leonard in right away. But we were waiting, trying to get a foothold, and he, of course, as he went on, he got a foothold in the butcher business. Se he has always followed that line, although it was not exactly his choice, and it was not our choice. But the condition made it so.

Q. Well, what about Mr. and Mrs. Gustafson—Rachel's and Leonard's ability to respond to a judgment, say of the size of that note at the time that they signed it, in 1943?

A. At that time they could have handled that

(Testimony of George Johnson.)

note very fine. They might have been able to handle a couple of them.

Q. What about Rachel, out of her own sole and separate estate?

A. Well, of course she had money in the Western Construction Company already.

Q. But even outside of that, could she have paid the note?

A. Well, you figure her half of the community—of estate, you mean?

Q. No. I mean without taking their community property into consideration—just her sole and separate estate. [148] She had money of her own that was not owned by Mr. Gustafson, didn't she?

A. Well, I really don't know exactly how much that was. She might have had $4,000 or $5,000 of her own.

Q. Yes. Now, this note was for how much?

A. It was for $5,000.

Q. Now, what about Roy and Albin starting with the partnership? I mean Roy and Winston starting with the first limited partnership in 1942? Did they do any work for the company?

A. Roy—I think it was in 1942 when he was working on the Alaska stock pile Transit shed, and he worked there——

Q. (Interposing): When you were preparing bid on it, did he work on that ?

A. Well, he worked preparing bids on it, then after we got it, why he was engineer there, and also assisted in the superintendence there.

(Testimony of George Johnson.)

Q. Do you remember what jobs you had in 1942? Perhaps I should not say that—do you remember what jobs you had after the creation of this limited partnership, we will put it that way.

A. Well, we had this job that I just mentioned, the Alaska Transit Shed. We also had the two pier sheds for the Port of Seattle down on the waterfront here.

Q. What was the size of those three jobs? [149]

A. Well——

Q. (Interposing): Were they large or small?

A. Well, those pier sheds I presume were something over a million dollars. I am not quite sure about that now, but they are large jobs anyhow.

Q. They were about half of that amount, weren't they—about $500, weren't they?

A. Well, now, it might be that. It could possibly be that they did not reach a million dollars.

Q. What other jobs, if any, did you have in that year after the formation of the partnership—the limited partnership?

A. Well, we had the Boeing work.

Q. Is that the job that has been referred to here as the cafeteria? A. That is right.

Q. Who did the work there?

A. Well, Roy was there, and my brother John was—he had sort of, say, to look after it.

Q. Now, let us go on with Roy. After 1942 what did Roy do—in 1943 and 1944?

A. Why, after—I don't remember now what

(Testimony of George Johnson.)

time it was that he went up to Alaska. That was some time in 1943 or 1944, wasn't it?

Q. I think I can state that Mr. J. A. Johnson testified [150] that it was in 1944. Would that refresh your memory?

A. Yes, I think it was in 1944, yes, that he went up to Alaska, but until that time he worked with us going from one job to another.

Q. What kind of work did he do?

A. Well, he done engineering work, and he also done the same as Lloyd done on the work. If it was a question of having someone to speak for you, why you send the fellow that could talk their language. I know down at the Alaska Transit Shed I was in a little hot water with the inspector there as to the material of fill there. It was specified a certain material for the fill. The inspector claimed that this did not come up to specifications. Well, I called on Roy to talk this specification to the inspector, and he untangled the snarl.

Q. You are not a graduate engineer, are you?

A. No, I am not.

Q. Neither is Albin, is that correct?

A. No, he is not.

Q. Now, Mr. Johnson, after these limited partnerships were formed, was there any change in the way that the general partners ran the business?

A. No, sir.

Q. Were there any meetings of any kind had with the limited partners as to the control over you as to running the [151] business? A. No.

(Testimony of George Johnson.)

Q. Do you know whether any certificates of interest in the business were ever issued to any of them? A. No.

The Court: He asked you if you knew. Do you mean to say that there were none issued?

The Witness: There were none issued.

Mr. Potts: Thank you, your Honor.

Q. (By Mr. Potts): Were there any officers elected by the limited partners or by the limited general partners?

A. No, there were no officers elected.

Q. Were there any committees, or a board of trustees, or a board of directors elected?

A. No. No board of trustees of any kind.

Q. Were there any by-laws adopted?

A. No by-laws of any kind.

Q. How were your records kept at the bank with respect to the authority to draw checks and to sign notes after the limited partnerships were formed?

A. Oh, the three of us—myself, John and Albin—we signed a card, and any one of the three of us—we didn't have to sign, more than one of us, to make a check valid.

Q. And what about on notes? [152]

A. Notes, if it was a big note, why I think that we were called in—the three of us.

Q. Were any limited partners' signatures ever secured? A. No.

Q. At one time, after the years in question here, there was another signature, was there not, authorized at the bank? A. Yes.

(Testimony of George Johnson.)

Q. What was the purpose of that?

A. Well, you mean when Albin went to Sweden?

Q. Yes.

A. Well, Albin authorized Winston, his son, to sign the checks in his place.

Q. Other than that was there any limited partner that had any authority to sign anything?

A. No. They had no authority to sign anything.

Q. Who ran the business?

A. J. A. Johnson and Albin and myself.

Q. The three general partners, is that right?

A. That is right.

Q. Now, with respect to the interest of the limited partners was there—will you tell the Court whether there were any restrictions placed by you, or if you know, by any other general partner on the right of any of the limited partners to withdraw any earnings, if there were any, from the company? [153]

A. No. When the money was earned, why any of the partners had the right to withdraw whatever they had earned.

Q. Did they do that?

A. No, they did not but, of course, we didn't do that either.

Q. Didn't any of the limited partners ever withdraw any money?

A. Oh, yes. But I mean that they didn't need to withdraw their money.

Q. Was there any understanding of any kind that you had with your limited partners—referring

(Testimony of George Johnson.)

to your children—or, as far as you know, with any of the other limited partners, that these notes were not to be paid out of their own assets if the company should fail?

A. No, but the understanding was that this was put up for to give us that much more carrying capacity.

Q. Can you tell the Court whether the limited partners understood that or not?

A. They were all told the meaning of it—fully—every phase of the proposition.

Mr. Potts: I think, if the Court please, I am through inquiring in chief, with the exception that I should like to reserve the right—we have two sets of notes there, and in order to get them introduced out of order I should like to withhold my examination regarding them until we can locate this [154] other original note.

The Court: Yes, you may do that. We will now take a ten minute recess. You are through with the witness at this time, I take it, Mr. Potts?

Mr. Potts: Yes, your Honor.

The Court: Very well, we will take a ten minute recess.

(Witness excused.)

(Recess.)

(Testimony of George Johnson.)

Cross-Examination

By Mr. Payne:

Q. Mr. Johnson, at the beginning of your testimony you said that Mr. Philip Johnson and Mr. Clyde Phillips were invited to come into the partnership at different times. A. That is right.

Q. You offered them yourself to give them an opportunity to put money into the partnership, is that right? A. That is right.

Q. And they didn't want to do it?

A. Well, Mr. Philip Johnson didn't want to do it. Clyde Phillips, he would have done it, but he would have wanted the biggest part of the profits.

Q. Did you offer them a proposition, like you offered the children?

A. Well, similar. They would have possibly gotten a [155] little better proposition than the children. In other words, we hadn't gotten to the point with Philip Johnson yet of talking really as to how much he was going to have, because he declined the offer or the invitation.

Q. Did you offer to give them the money to start with and put in the business and take a note, and let them pay you back, if, as and when they could?

A. If Philip Johnson would have been willing to give us a proposition, giving us a note, it would have been just as valuable to us as money, because he really could have acted.

Q. I asked you if you offered him the money to come back to you, would you give him an interest?

(Testimony of George Johnson.)

A. I asked him if he would invest money with us.

Q. And he didn't want to do it? A. No.

Q. You said that as a result of your ararngements with the children on the limited partnership agreements, you had $60,000 in notes. Those were your individual notes, and not the partnership notes, were they not?

A. Yes. In other words, on my personal statement I could show a $20,000 asset there that I didn't have previous to that time and——

Q. (Interposing): Wait a minute now. You mean on the partnership statement, or on your own individual statement? [156]

A. I mean on my own individual statement.

Q. Oh, yes.

A. But the individual statement was always used in the partnership for backing of any kind.

Q. Well, now, what about the amounts that you set over to the children—the $20,000 that you set over to the children in the partnership? Where did that come from?

A. The $20,000 that was set over to the children came from George Johnson, and it was put into the partnership, and that is what they gave the note for.

Q. And they gave the note back to George Johnson to offset that amount? A. That is right.

Q. The partnership itself didn't have any more assets than it had before, did it?

A. No. You might say that the same amount of

(Testimony of George Johnson.)

money was in the pot, but we had $60,000 worth of notes, which were an asset to the three general partners.

Q. To you individually?

A. Well, yes, to the three individual partners.

Q. Now, when did Lloyd go with Kuney?

A. Oh, I would say the latter part of 1941—somewheres around there.

Q. He had formed a partnership with Kuney before you made this new partnership arrangement, isn't that so? [157]

A. Oh, I really don't know if he had formed any other partnership than that he went and figured on a job.

Q. I show you Petitioners' Exhibit No. 6, and ask you if this does not say, "Kuney-Johnson Company, Contractors." A. That is right.

Q. With Max J. Kuney and Lloyd W. Johnson.

A. Yes, but what partnership they had perfected I don't know yet—just exactly what kind of a partnership they had. By this time they no doubt did have some written documents, but you a good many times go and figure a job with somebody without a partnership agreement, and I do not think that it was Lloyd's idea, when he went on this first job, that he would be with Kuney very long. In other words, he figured this job, and it turned out to be pretty good, and they figured another one, and so forth.

Q. When was Lloyd on the Montana job that you spoke of? A. Lloyd had no interest in that.

(Testimony of George Johnson.)

Q. Well, when was he on that, that is my question. A. When was he on that?

Q. Yes.

A. Well, I presume that that must have been around 1937, I should judge.

Q. You did not identify it, and I wanted to know when it was. So he had been working with Kuney off and on——

A. (Interposing): Well, he was working on that one job [158] for Kuney, and after he was through there he came back and worked—he came back and worked quite a while with us, and then for some reason or other he met Kuney here in Seattle on a visit here, and they commenced to talk, and Kuney said that he would like to figure this job and, "Would you like to help me figure it?" So he helped Kuney to figure the job, and they got it. Kuney was not a general contractor. He was a dirt moving contractor, so that is why he wanted Lloyd's ability to figure this building contract.

Q. When did Lloyd do estimating for you? I was not very clear on when he did it. Did he do odd jobs for you?

A. Oh, yes. He did odd jobs for us right along after he was with Kuney.

Q. How much time did he spend with you in 1942, do you know?

A. Oh, I would say that it would average—oh some time around—counting the hours that he spent, that it would average maybe a day a week. In other words, contracting is sort of peculiar. One day you

(Testimony of George Johnson.)

have a little leisure, and then the next day you start working at 7 o'clock in the morning and you may work until 2 o'clock at night before you go home. That is you do that the day before you turn in the bid. I thought you possibly were pretty well acquainted with those things.

Q. Are you talking about 1942? [159]

A. I am talking about 1942, yes, sir.

Q. What about 1943?

A. That was quite a common occurrence, that we would be short of time and short of help, and we would ask him to come and give us a lift. And some time he came out either to my brother's house or my house, if he figured it was easier to go home, and have something to eat, and then he would not have to go down to the office.

Q. Don't you think that he might have done that for you even aside from any partnership connection, being your son?

A. Well, I don't know. It is easier for anybody to help and push up hill if they know that there is something in it for them.

Q. You would be disappointed if he didn't do it for you, wouldn't you?

A. Well, you would not expect a man to come week after week and give you a lift and not have anything in it.

Q. Now, you didn't ever pay Lloyd on a salary basis, like you did Winston or Roy, did you?

A. No, because whenever he helped us, it was just in a spell like that, but Roy has helped us a

(Testimony of George Johnson.)

good many times since he started in Alaska. As a matter of fact, he now looks after our business, you might say, entirely. We are not down at the office, but he looks after things that need to be looked after there. He has an office right in our—in fact, he is in our [160] office right now.

Q. You said that Lloyd sometimes helped you, and you introduced Petitioners' Exhibit 6 to show that he helped you get some nails one time?

A. Yes.

Q. Didn't you help anybody during the war years on materials?

A. I do not think that I helped anybody that was outside of my immediate family. In other words, why should I help my competitor?

Q. Well, of course Lloyd was in the family, however, and you might expect a little more help from him on that account, might you not?

A. Well, in other words a lift like that—I will tell you how hard the nails were to be gotten. When we were working at Holly Park I went out with my car and I went through Seattle, and I went through Everett, and Marysville, and the small towns around here, and I bought nails by the five pound packages—anything from five pounds up to a keg of nails, and when I got back in the evening I might have a couple of hundred pounds of nails, having spent a whole day trying to get them. That is how hard nails were to get at that time. And I remember that at Marysville the price of nails was

(Testimony of George Johnson.)

supposed to be $3.60 for twenty penny nails, and I bought a keg of nails in Marysville that I paid $8.00 for. [161]

Q. Mr. Johnson, I show you Petitioners' Exhibit 7, and I will ask you if you were the administrator of the estate of your former wife?

A. Yes, sir.

Q. And you also became the guardian of your minor children? A. That is right.

Q. And you testified as to the contents of that exhibit and the interests in the estate which were due the children as shown by the Court order?

A. Yes, sir.

Q. Now, what happened to this partnership along in 1935 and 1936—the Western Construction Company partnership?

A. Well, I think I have explained that pretty thoroughly, what happened to it.

Q. Well, what about the Coulee Dam job?

A. We lost money on that.

Q. How much? Everything you had in the partnership?

A. Well, pretty well, we were pretty well cleaned out.

Q. Were you completely cleaned out?

A. Well, we didn't go bankrupt, but we were pretty badly bent.

Q. What do you think that this interest would have been worth at the lowest point of the status—the financial status of the partnership along in 1935,

(Testimony of George Johnson.)

1936 and 1937? [162] What would the interests of these children have been worth—I am asking you if you know.

A. That I would not be able to say. Before I could answer that I would have to have somebody that knows bookkeeping to see what that would be. And it would also be pretty hard to say because it depends on how much you could sell that property that I had at that time.

Q. What property did the partnership have? I thought that they were completely out of business for a period.

A. Well, the property that we had at that time —at that time we had it up as collateral at the bank, but the bank never foreclosed on us. They said, "We know you fellows, and we will do all we can for you." Of course, there is a limit that a bank can do, but what they could do, why they were always willing to do.

Q. Did you individuals have to go out and try to dig up money to pay off your debts?

A. Oh, sure, we tried all the time to pay off our debts.

Q. Did you pay them all off?

A. There is not a single one that lost a penny on us, even with that big loss. There is not a single one who can say they lost money on the Western Construction Company.

Q. The interests which the children had in this decree of the Court were still subject to the operations of that partnership, were they not? [163]

(Testimony of George Johnson.)

A. Well, I feel even if I had gone broke at that time and I lost the children's money, it would have been my place, if I could get on my feet again, to repay them, just the same as I repaid the other people that I owed money to. Don't you think so?

Q. As a business matter, yes, but a moral matter it might make a different result. But you cannot say what value it was in 1936-1937 when you had your partnership closed?

A. Well, I know those few dollars, they were of real value to me to hang on and try to get on my feet again.

Q. If you had it.

A. Well, we had a few dollars, and they were really precious, and the few dollars that we had were not spent on fancy hats either. I will tell you that.

Q. You gave testimony about Bernice Wallin. You said that she had a home. Wasn't that her home and her husband's home?

A. They had it together.

Q. Do you think it was paid for, or do you know?

A. Well, I know that it was—at least it was paid for, the most of it. I am not quite sure if they owed anything on it, but I am quite positive that it was all paid for.

Q. When?

A. When it was bulit. When they built it. [164]

Q. When was it built?

A. Oh, it was built a couple of years prior to that.

(Testimony of George Johnson.)

Q. Prior to what? A. Prior to 1942.

Q. One question I forgot to ask you. Did you keep records for the children in connection with the estate of your deceased wife? Did you keep an accounting for them with respect to this estate—Petitioners' Exhibit No. 7?

A. Well, there wasn't any accounting to keep because as long as I didn't pay them, why they still had that interest with me.

Q. This estate has not been finally closed yet, has it? A. No.

Q. Are you still guardian?

A. Well, I am not still guardian, but when they became of age I talked this over with them and asked them if they wanted the money, and I told them that if they left it in I would be very happy to have them leave it in.

Q. Did you ever make an inventory or an accounting to the Court with respect to these children? A. No.

Q. You have never been released then, have you?

A. I don't think so.

Q. So this thing is still hanging over for final disposition? [165] A. That is right.

Q. You stated with respect to the note that you received from your children that you wanted it to show to the bonding company. Did you ever tell the company—the bonding company that it was given for a stated interest in the partnership?

A. Yes.

(Testimony of George Johnson.)

Q. Did they know that that was to offset an interest which was set out in the partnership books for the children?

A. Yes, but the agents that we done business with here in Seattle, it was to their interest to see that our estate or partnership was built up so that they in turn could turn in a report to their office. In other words, for to get a bond on two million dollars you have to show an asset of a certain amount, and they have certain schedules and rules to go by, and to comply with those rules a person who asks for a bond has to have an asset of approximately so much before they can authorize the bond.

Q. Do you know what your partnership account showed before the formation of the partnership? Do you know the amounts?

A. Before the formation of what partnership?

Q. Before the formation of the limited partnership. A. You mean when we——

Q. (Interposing): You do not remember without the books [166] and records, is that it?

A. You mean when we first formed the Western Construction Company?

Q. No. In 1942.

A. When we formed the limited partnership?

Q. Yes.

A. No, I would not attempt to say what that asset was at that time. I know that we were terribly hard up for money and for financing, because we had to figure jobs in smaller brackets all the

(Testimony of George Johnson.)

time. Instead of coming up to a couple of millions of dollars, why we had to stay down in the second bracket in order to get the bond.

Q. In answer to Mr. Potts' question about the interests of the children in the estate of their mother, you said that if you had paid them and put that money back into the partnership it would be just taking money out of one pocket and putting it in another one. Is that the term that you used?

A. That is right.

Q. Wouldn't you say that the formation of the limited partnership was the same thing?

A. No, because the formation of the partnership was made on the basis that the children give us partners the amount of $60,000 worth of personal notes.

Q. Let me ask you this, did you give some money to the children in 1944 at the time that the partnership was formed? [167]

A. I think the evidence will show quite clearly that this money that was set aside for the children was from George Johnson, J. A. Johnson and Albin Johnson.

Q. Let me ask you this, did you give Lloyd a check for $10,000?

A. I really don't know if it was a check now, or how it was transacted. But I gave Lloyd money to buy in this partnership with.

Q. Do you know what date you gave it to him?

A. No, but of course there are things by which

(Testimony of George Johnson.)

we can find that out. We can find the checks on that, and that will tell us.

Q. Did you give it on condition that he would put it back in the partnership?

A. Well, naturally, it was arranged that he would buy this money with the note.

Q. Let me ask you this, did he endorse the check and give it back to you, or did he put it in the bank and give you his check?

A. Well, I really don't know. I don't know how that was transacted.

Q. Who does know?

A. I think our bookkeeper can inform you as to that.

Q. I see. Now, when Rachel and Lorraine came in, you said that they negotiated with the other two children, is that [168] right?

A. That is right.

Q. Why did they give you notes instead of to the children—why did they give you notes instead of to Lloyd and Bernice Wallin?

A. Well, because the first notes—they were given back to the children.

Q. What is that?

A. The first notes, and they all gave us new notes.

Q. You mean in 1943? A. In 1943.

Q. I see.

A. Yes, they all gave us new notes. It would have been the same thing, I think, but the first notes

(Testimony of George Johnson.)

were given back and the new notes were taken from all of them. Is that clear?

Q. When was Mr. Ellingson in the Marines—what year?

A. Well, he was in early. I think he was one of the first ones—he enlisted as soon as the war was declared.

Q. Was he back before 1942?

A. Well, that is just about the time that he came home.

Q. Did he work for the partnership?

A. As soon as he got back, yes.

Q. You don't remember what year?

A. No, I don't. [169]

Q. What kind of work did he do? You didn't tell us. A. He did carpenter work.

Q. I see. A. And foreman's work later on.

Q. And you paid him the same as you did other men of that caliber? A. That is right.

Q. How long did that continue before he went out?

A. Oh, that continued as long as we had any work.

Q. Is he the man that went into the butcher shop? A. Oh, no.

Q. That was Gustafson?

A. That was Gustafson.

Q. You said Gustafson had money in the Western Construction Company. What do you mean by that?

A. You mean Mrs. Gustafson, don't you?

(Testimony of George Johnson.)

Q. I beg your pardon.

A. You mean Mrs. Gustafson?

Q. Oh, did you mean Mrs. Gustafson? You meant your daughter? A. Yes.

Q. You said that she might have $4,000 or $5,000, but you were very general about that. What did you mean by that? A. Well——

Q. (Interposing): You just mean that you don't know, [170] or are you just speaking generally? A. Oh, no. I know that.

Q. How do you know that?

A. Well, I know that they have some money. I don't——

Q. (Interposing): Well, I mean in 1942.

A. Yes. That was the time that the butcher business might have been pretty good. Lately here meat is too scare and you cannot make much money as a butcher.

Q. Did he have a shop of his own, or was he working for a salary?

A. Oh, yes, he has a shop of his own. He has had it for years.

Q. Then that would be community property, whatever he made in that?

A. Yes, so I understand, but I know that she has some money.

Q. But she has no special interest in that—she is just interested with her husband, is that it?

A. Well——

Q. (Interposing): Well, never mind. Now, you

(Testimony of George Johnson.)

said that Roy did some estimating for you. Did he do that for you in 1942? A. Who?

Q. Roy. A. Roy Johnson? [171]

Q. Yes. A. Yes, sir.

Q. You didn't pay him anything in 1942, did you?

A. Well, we didn't pay either one of the boys if they just happened—if they came in and gave us an afternoon and night. But when they worked steady, then they got paid.

Q. That is why you didn't pay Roy in 1942?

A. I know that he helped us estimating evenings and in the afternoons, and little stretches like that. But for that they never asked pay.

Q. What year was the Boeing work done that you testified about?

A. Well, that was the latter part of 1942, wasn't it?

Q. I am just asking you. You testified that there were no certificates of interest given to the limited partners in connection with these partnership agreements. Were they given signed copies of the partnership agreement itself?

A. Well, I don't think so. I do not think there were any signed copies given to them.

Q. You said that Albin authorized Winston to sign his name for him while he went to Sweden.

A. Yes.

Q. What year was that?

A. Oh, that was—well, it was about a year ago

(Testimony of George Johnson.)

since Albin left for Sweden—a little earlier than a year ago. [172]

Q. That was since 1945? A. Yes.

Q. That was just a temporary arrangement?

A. Well, yes. That was while he was in Sweden.

Q. When Albin returned that was withdrawn from Winston—that temporary arrangement ceased, did it?

A. I really don't know. I really don't know whether that was withdrawn or whether it is still in effect. I would not say.

Q. You said that you general partners did not draw anything from the partnership. Do you happen to know what your personal drawings were during the year?

A. Well, did I say that we didn't draw anything?

Q. That you didn't draw anything—you didn't draw much, or you didn't have to.

A. Well, we didn't draw any more than we had to.

Q. You said that the children were told all phases of the proposal or proposition about the signing of these notes? A. Yes, sir.

Q. Did you also tell them that you expected to make enough money so that they would not have to worry about paying the notes out of their own pocket?

A. Well, I really don't know if I told them in those words, but I told them that we had a fair idea of making some money, but there was also a

(Testimony of George Johnson.)

chance in the contracting business [173] to lose money. In other words, they knew that. They lived with me during the years we were in Coulee Dam, and they knew how we were sweating for cents over there, and for dollars.

Q. You had the Rainier Beach government contract at that time, didn't you?

A. Well, I don't remember exactly what contract we had at that time. If you want to know that, I think the books are open to you. You can look at them and see just what contracts we had.

Q. I am asking you what you knew about it. You were running the business and you would know all about these things. You ought to know what contracts you had when this contract was signed. Your memory ought to be pretty good.

A. I must admit that my memory is not as good as it used to be, Mr. Payne.

Q. But you made some money in the business on the West Park project, didn't you, in 1941?

A. Yes. It turned out to be pretty good. To begin with we thought perhaps we would have another Coulee Dam, the way it looked. When we started out at West Park, it rained every day, and we could not drive in with a truck anywhere. The lumber had to be unloaded and then a chain had to be put around it to snag it with a caterpillar into place. [174]

Q. And you made money in spite of that, didn't you?

(Testimony of George Johnson.)

A. Well, when the dry weather came, why we done fine.

Q. And did you tell the children that you had expectations of making some more money in 1942, and later?

A. Naturally, we expected to make some money, but if it turned out as good as West Park, nobody could tell that.

Q. Did you tell them that you expected to make money so that they would not have to dig up the amount of those notes? A. No.

Q. You did not?

A. That is one of the reasons why Rachel didn't want to go in right away. She was a little leary of it, and we didn't want anybody—we didn't want to coax anybody either.

Q. Do you know what your partnership's stated capital was in that first partnership in 1942?

A. Well——

Q. (Interposing): Just state if you remember.

A. No, I don't remember.

Q. Let me ask you this, did you and J. A. Johnson and Albin Johnson use your own personal money and your own personal credit to further the work of these contracts carried on under the limited partnership agreements?

A. Well, we all—we used our own personal money to the very last penny. [175] When you signed on one of those bonds, well, you might as well say that you signed away everything to the last penny.

(Testimony of George Johnson.)

Q. I will ask you this, do you know how much stated partnership interest you had under that first agreement of February, 1942? Do you know how much was your stated partnership, or interest, or capital?

A. I must admit that I cannot tell you.

Q. You would not know whether it was $5,000, or $15,000 or $10,000?

A. Oh, it was more than $5,000. But you see, Mr. Payne, when you are contracting—as long as you take one contract, then you have that fairly defined, but you have ragged ends. The bonding company, as soon as you have that work going, they count that as a liability to you. You cannot come to a bonding company and say, "Here, I am pretty near finished on that job, and I am making about $20,000 on it." Because, as long as that contract is not closed that is set up like a liability to you. And then when you want to ask for a bond for more contracts, you have to show that you have an asset to a certain amount to warrant you for to get that bond.

Q. All right. Now, let me refresh your memory a little bit. You said that the children put in $60,000 in notes? A. That is right.

Q. You three general partners didn't have that much in the first partnership, did you? [176]

A. Cash money you mean?

Q. You didn't have that much stated capital in the first partnership, did you?

(Witness does not answer.)

(Testimony of George Johnson.)

Q. Isn't that true, that the children had more than you general partners—more than you three general partners had in the first partnership?

A. No, I don't think so.

Q. You do not think so? A. No.

Q. Well, will you get the books and records and show the Court what you had?

A. I think if you want to, you can have Mrs. Potts show you the records, which will tell you exactly how the status was. We haven't got anything, as far as I know—I know this partnership has not got anything to hide away from you fellows.

Q. Let me ask you this then, Mr. Johnson. In connection with that first partnership in 1942 did you use more than $15,000 capital as your own in that business—in 1942 I am speaking of?

A. Well, I would say that we would not have gotten very far with $15,000.

Q. You could not have gotten very far?

A. No. [177]

Q. I mean, just your own capital.

A. Our own capital—we could not get very far with $15,000.

Q. You think that you had more than that of your own money in the business?

A. I would think so.

Q. But you don't know? A. No.

Mr. Payne: That is all. We would like to reserve the right to call the witness back again after we get the figures into the record of the partnership.

The Court: Very well.

No. 12806

United States
Court of Appeals
for the Ninth Circuit.

COMMISSIONER OF INTERNAL REVENUE, Petitioner,
vs.
WESTERN CONSTRUCTION COMPANY, Respondent.

COMMISSIONER OF INTERNAL REVENUE, Petitioner,
vs.
ALBIN JOHNSON, Respondent.

COMMISSIONER OF INTERNAL REVENUE, Petitioner,
vs.
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COMMISSIONER OF INTERNAL REVENUE, Petitioner,
vs.
J. A. JOHNSON Respondent.

Transcript of Record
In Two Volumes
Volume II
(Pages 335 to 701)

Petitions to Review Decisions of the Tax Court of the United States.

FILED
APR - 6 1957
PAUL P. O'BRIEN,
CLE

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.

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(Testimony of George Johnson.)

Mr. Potts: At this time I would like to introduce another exhibit. Will you mark this for identification, Madam Clerk?

(Document above referred to marked Petitioners' Exhibit 8 for identification.)

Re-direct Examination

By Mr. Potts:

Q. Showing you, Mr. Johnson, Petitioner's Exhibit 8 marked for identification—this is a copy of this sheet from this book (indicating)—can you tell the Court what that exhibit is?

A. Well, it is a deposit—a bank deposit of $20,022.36. [178]

Q. To whose credit—to whose account?

A. That is to the credit of the Western Construction Company.

Q. And the date?

A. It was 5-12-42. It was $10,000 from Bernice Wallin and $10,000 from Lloyd Johnson, and Oscar Hanson $22.36.

Q. The Oscar Hanson item has nothing to do with the capital account of the limited partners, has it?

A. Oscar Hanson, if I remember right, he is a gardner. He has nothing to do with that.

Q. Can you tell the Court whether these items of $10,000 deposited from Bernice Wallin and Lloyd

(Testimony of George Johnson.)

Johnson covered their investment in the limited partnership, or not?

Mr. Payne: I object to the word, "investment," because we do not believe that there was any investment.

The Court: Well, as we announced some time ago, Mr. Payne, the Court is not going to be influenced by the form of the question of either party.

Mr. Payne: All right.

A. Yes. Bernice Wallin deposited $10,000, and Lloyd Johnson $10,000, on the fifth month, the 12th day in 1942 as an investment.

Mr. Potts: We offer Petitioners' Exhibit 8, Your Honor, in evidence, which is a copy of the deposit slip.

Mr. Payne: No objection. [179]

The Court: It will be received as Petitioners' Exhibit 8.

(Document heretofore marked Petitioners' Exhibit 8 for identification received in evidence.)

Mr. Potts: I think that is all from this witness, with the exception that I have stated before.

Recross-Examination

By Mr. Payne:

Q. May I ask you, Mr. Johnson, where that money came from, from Bernice and Lloyd Johnson? Where did they get that money, do you know?

A. Well, they got it from George Johnson.

(Testimony of George Johnson.)

Q. How did they get it? A. Well——

Q. (Interposing): Did they get it by——

A. (Interposing): By check.

Q. Do you know on what date—was it before this date?

A. Oh, yes, it was before that date.

Q. Now, did they endorse the check back to you, or did they give you a separate check, or did they give you cash, or how was that handled? Do you know?

A. I think our bookkeeper can tell you that.

Q. Anyway, this was a return to the Western Construction Company of the same amounts which you had given to them [180] previously?

A. Well, you will get that clear from the bookkeeper.

Q. I am asking you now. You ought to know.

A. If it was the same amount, I don't know for sure.

Q. Are these the same amounts as the notes?

A. These are the same amounts as the notes.

Q. And you gave them—you understand that you gave them previously enough money to take care of their obligation under their agreement to put that much money in the partnership?

A. Yes, sir.

Q. And you first gave it to them so that they could give it back to you?

A. In other words, it works out this way, that the same money as I had—in other words, the

(Testimony of George Johnson.)

money is no more or no less, but the children have guaranteed the payment, the loan of that money by a note, and in case that it would have been a loss in any of the future years, so that it would have been a loss instead of a gain, those notes are negotiable notes and that money—well, I believe the children could not have evaded paying them.

Q. Did you tell them to give the money to the Western Construction Company instead of to you?

A. Well, I really don't know that I told them, but it was naturally to give the money to the Western Construction [181] Company.

Q. Was it this way according to the plan when you drew the instruments, that you would give them the money and they would put the money in?

A. That is what we thought after we had this deal with Erickson of $60,000, and we had to pay 40 per cent of that gain for to borrow enough. You can see how ridiculous that was. Here we have $60,000 guaranteed by ten notes. At that time it was a personal proposition of ours that guaranteed $60,000, and it was guaranteed that if we had a loss—instead of $60,000 we could not have realized $6,000 out of it if there would have been a loss. And, Mr. Payne, we took about 40 per cent of that profit to West Coast Construction Company.

Q. Mr. Johnson, do you know how much money —what the amount of the profits credited to the children were in 1942 on their so called stated investments?

A. I don't remember for sure how much that

(Testimony of George Johnson.)

was, but it was a fairly good sized amount. It was several times more than I expected, in fact much more than I expected.

Q. Three or four times as much as their stated capital accounts?

A. Yes, I would not be surprised but what it would be. I don't remember now for sure how much it was, but it was beyond my [182] expectations.

Q. That was almost as big as the Erickson deal, wasn't it?

A. Well, yes, but we got some good out of it, didn't we?

Q. Who did? A. Well, the group.

Q. The family, you mean?

A. It didn't go out of our family.

Q. I see. That is the thing that you were working for, isn't it?

A. You know, I raised those children, and I looked forward to a day when I could lead them into a good business, and I still wish every one of them good luck. If I can give them good advice, I will do that right today even.

Q. Now, let me ask you one other thing——

A. (Interposing): You would do the same thing, wouldn't you?

Q. Did you discuss this among yourselves, or did someone advise you on this matter how to go about this?

A. Oh, after we come to think of it, that we possibly could maneuver and raise $60,000, we talked

(Testimony of George Johnson.)

this over with our attorney and wondered how that could be done.

Q. You didn't raise $60,000, however, did you?

A. We raised an asset to $60,000.

Q. What did you do with the notes, Mr. Johnson? [183]

A. Well, the notes are right there.

Q. Well, that is not cash.

A. No, but I say that it was an asset.

Q. Well, what did you do with the notes. Put them in your vault?

A. Well, naturally we would put them in the vault.

Q. You did not pledge them with the bank, did you? A. We surely did.

Q. When?

A. Well, I think you will find that——

Q. (Interposing): I am asking you now. You say that you did. I want you to get the information for me right now.

A. I know that we pledged them with the bonding company.

Q. With what?

A. With the bonding company.

Q. But you don't know about pledging them to a bank?

A. I am not sure, but I think that the bank knew about it.

Q. But the notes weren't cash, were they? You could not spend the notes, and you didn't spend the notes?

(Testimony of George Johnson.)

A. Yes, but here—well, it is an asset that credit supports.

Q. The notes were not paid up until 1945, were they, Mr. Johnson? They were not paid up to 1945, were they?

A. The notes, I do not think that they were all paid up to 1945. [184]

Q. Do you think any of them were?

A. Yes, I think some of them are being paid now.

Q. Which ones?

A. I think that you can also find that out from the bookkeeper.

Q. You are in a position to know about notes. These notes came to you personally. No one else would have the same knowledge as you would have about them. Sometimes we do not get the information if we ask a man who does not have the right to know. But here you are in a position to know. Now, did Lloyd pay you his note?

A. I think so.

Q. When? A. Oh, quite a long time ago.

Q. When? 1946 or 1947?

A. I don't know exactly what date that was.

Q. You don't know?

A. I don't know for sure what date it was now.

Mr. Payne: That is all.

Mr. Potts: That is all.

(Witness excused.)

Mr. Potts: I will call Mr. Albin Johnson.

Whereupon,

ALBIN JOHNSON

called as a witness for and on behalf of the Petitioners, [185] having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Potts:

Q. State your full name.

A. Albin Johnson.

Q. Where do you reside, Mr. Johnson?

A. At 1061 East 88th Street, Seattle.

Q. Can you talk a little louder?

A. Yes. At 1061 East 88th Street.

Q. How long have you been a resident of King County, State of Washington?

A. Oh, since 1911.

Q. And where had you lived before that?

A. I came direct from Sweden to Seattle.

Q. And how old were you when you came here from Sweden? A. 18 years old.

Q. Are you a citizen of the United States?

A. Yes, sir.

Q. Where were you naturalized?

A. In Seattle.

Q. In this district? A. Yes.

Q. Now, when you came here from Sweden what kind of [186] work did you do here?

A. I started with my brothers as a carpenter.

Q. What brothers were those?

A. That was George and John.

(Testimony of Albin Johnson.)

Q. Did you become a partner with them?

A. Well, I worked for them for many years as superintendent, until about 1925.

Q. And what did you do then?

A. Then I went in and built—done some building with my brother, Carl Johnson.

Q. Another brother? A. Yes, sir.

Q. And not involved in this particular matter?

A. No, not involved in this particular matter. I did that until 1934, and then I went in business with George and John.

Q. Is that the partnership spoken of here in 1934 of George and John? A. That is it.

Q. And what work did you do after that?

A. Then we went down to Coulee Dam and built those bridge piers.

Q. What happened to that job?

A. Well, we lost a lot of money on that job. I lost all the money that I made before. [187]

Q. After Coulee Dam—after that job was through, what did your partnership do?

A. Well, after we were through down at Coulee Dam, we went in as a corporation, or organized as a corporation, because we were so badly bent down at Coulee Dam. So we had to.

Q. Was that the corporation that has been testified to here by George and John Johnson?

A. That is it.

Q. After that corporation was dissolved, what work did you do in the partnership?

A. We started in 1940—we started the West

(Testimony of Albin Johnson.)

Park Project in Bremerton under the partnership.

Q. Now, you have heard John Johnson and George Johnson testify before you here?

A. Yes.

Q. Did you have any negotiations regarding Philip Johnson or Mr. Phillips or Mr. Granston?

A. Well, I was not together with them when they went over and saw Mr. Granston, but we talked about it.

Q. You weren't with them?

A. No. And Phil Johnson, when he was in our office, I overheard that conversation.

Q. Can you give us about what time that took place?

A. Well, it was before we went into—before we got [188] the West Park Project job. I am quite sure it was. It was during that time that we wanted to branch out and get bigger contracts, and in order to do that we needed some money.

Q. Well, did you succeed in getting any outside money or credit?

A. Then we asked Clyde Phillips. Of course he would have gone in with us, as has been testified to, but he wanted such a big percentage, so that could not be done. So he got our brother-in-law to go together with us.

Q. That was Mr. Erickson?

A. That was Mr. Erickson, in order to get the bond.

Q. And you were able to get the bond by getting him in, is that right?

(Testimony of Albin Johnson.)

A. Yes, sir. Of course, I don't know how he got that bond.

Q. Is this correct, Mr. Phillips got the bond, Mr. Phillips who got Mr. Erickson to go in with you. Mr. Phillips got the bond for you?

A. Yes, sir, Clyde Phillips.

Q. He was an insurance man that wrote bonds for contractors.

A. Yes. He was a bondsman.

Q. And now, what was the reason, Albin, for starting that limited partnership which was begun in 1942 by the general partners, and taking into the partnership some of your [189] children?

A. Well, the reason was because of the expense that we had before. If we had had those limited partners when we went down to Coulee Dam, the bonding company would not have had to finish up the job for us. They really had to come down there and help us to finish up the job. If we had had backing like that, and we had talked it over to get some money to swell our assets, why we would be getting along better. And we tried to get money from other sources, but we did not seem to have any luck.

Q. All right. What children did you take into the limited partnership—the first one I am referring to—organized in 1942?

A. I took in Elsie, my daughter.

Q. Was she married?

A. Yes, she was married.

(Testimony of Albin Johnson.)

Q. What was her name—her married name?

A. Keil.

Q. Elsie Keil? A. Yes.

Q. What was her husband's occupation?

A. He was a painter.

Q. A house painter? A. Yes.

Q. And did they own any property? [190]

A. No, I don't think so at that time.

Q. Was he employed? A. Oh, yes.

Q. How old was Elsie?

A. At that time she must have been about 25 or 26.

Q. And how old was her husband?

A. I cannot tell you that.

Q. Was he older or younger?

A. He must be a couple of years older.

Q. All right. Now, who besides Elsie did you take in? A. Winston Johnson.

Q. And what was Winston's age?

A. He was about 24 at that time.

Q. What was his education?

A. Engineer. He had gone three years in the University of Washington here in Seattle.

Q. You say three years? A. Yes, sir.

Q. He did not graduate from the University, did he? A. No.

Q. What was the reason for that?

A. He had to go into the Army, you see.

Q. What branch of the Army did he go into?

A. It was the Army—it was with the Army Engineers.

(Testimony of Albin Johnson.)

Q. With the Army Engineers? [191]

A. Yes, sir.

Q. How long was he in the Army, do you know?

A. Oh, it was only a short while. Either two or three months, or whatever it was.

Q. And what was the reason that he was sepaated from the Service?

A. He got eczema from wearing woolen socks and he could not get rid of that.

Q. So he was discharged from the Service?

A. Yes, sir.

Q. When did he get back here, approximately?

A. It was the first part of 1943. I am not so sure on that.

Q. Was it 1942 or 1943?

A. The last part of 1942.

Q. Did he join your organization—the limited partnership—when he returned.

A. Oh, yes—sure.

Q. How long did he stay with you?

A. He has been staying with us all the time.

Q. And now, as to Winston—let me see. Were those the two that were members of the partnership in 1942? A. Yes.

Q. How did they acquire their interest in the partnership—how did Elsie and Winston acquire their interest in [192] the partnership?

A. I loaned them the money, and they gave me a note for it.

Mr. Payne: I didn't get that answer.

(Testimony of Albin Johnson.)

The Court: Read the answer, Mr. Reporter.

(Last answer read.)

Mr. Potts: I will have this marked for identification.

(Document above referred to marked Petitioners' Exhibit 9 for identification.)

Q. (By Mr. Potts): Showing you the originals and these photostat copies which are marked as an exhibit, Mr. Johnson, I will ask you to tell the Court what this exhibit is, this exhibit marked for identification as Petitioners' Exhibit 9.

A. Those are the two notes that I received for the money that I loaned them.

Q. Will you tell the Court the date of these notes?

A. It is April 21, 1942, $10,000 at 4 per cent interest.

Q. For how long does it run?

A. Two years.

Q. And is this other note here the same.

A. Yes, the same thing is in the other note.

Mr. Potts: We will offer in evidence, if Your Honor [193] please, Exhibit No. 9 marked for identification.

Mr. Payne: No objection.

The Court: Petitioners' Exhibit 9 for identification will be received in evidence.

(Document heretofore marked Petitioners' Exhibit 9 for identification received in evidence.)

(Testimony of Albin Johnson.)

Q. (By Mr. Potts): Now, when the second partnership was formed in the next year—in 1943—were any additional children of yours taken into that partnership? A. Yes.

Q. Who was that?

A. Vedola Johnson.

Q. What is her age?

A. 21—I mean at that time.

Q. Was that her age at that time?

A. Yes, that was her age at that time, 21.

Q. Was she married at the time?

A. No, not at the time.

Q. By the way, were there any other of these limited partners that were unmarried except Vedola?

A. Yes. Winston was unmarried—well, I believe Winston was married.

Q. Just Winston and Vedola were the only ones, is that [194] correct, that were unmarried?

A. That is right. Winston and Vedola were not married.

Mr. Potts: Mark this for identification if you will, please, Madam Clerk.

(Document above referred to marked Petitioners' Exhibit 10 for identification.)

Q. (By Mr. Potts): How did Vedola secure her interest in the partnership in the next year, June 30, 1943?

A. The other children turned in their notes and

(Testimony of Albin Johnson.)

divided their interest in the company with Vedola, and they gave new notes.

Q. Now, Vedola, you say was not marired?

A. That is right.

Q. I will ask you whether or not she was engaged at that time.

A. Yes, she was engaged.

Q. And can you tell us when she was married, if she was married?

A. In January of 1943 she was married.

Q. In January of 1943? A. Yes, sir.

Q. Do you mean 1943?

A. Yes, I am quite sure of that. [195]

Q. Showing you the original notes——

A. (Interposing): No. In 1944 she was married.

Q. You wish to change that to 1944?

A. Yes, 1944.

Q. All right. Now, showing you Petitioners' Exhibit 10 marked for identification, will you tell the Court what those are?

A. Those are the renewed notes that they made then for $6,666.66 apiece.

Q. And they are signed by whom?

A. By Vedola Johnson, Winston Johnson and Elsie Keil.

Q. And what is the term of those notes?

A. Two years.

Q. Is interest provided there? A. Yes.

Q. How much interest?

A. 4 per cent per annum interest.

(Testimony of Albin Johnson.)

Mr. Potts: We offer then in evidence Petitioners' Exhibit 10, if the Court please.

Mr. Payne: No objection.

The Court: That will be received as Petitioners' Exhibit 10.

(Document heretofore marked Petitioners' Exhibit 10 for identification received in evidence.) [196]

Q. (By Mr. Potts): In bringing in your children as partners, and in lending them the money on these notes, what conversations did you have with them regarding the payment of the notes?

A. Well, that they would have to pay the notes; that they would be responsible for the notes.

Q. Was there anything said about the fact that if the company lost money they would not have to pay the notes?

A. No, there was nothing said on that.

Q. Was there any restriction of any kind placed upon the limited partners in drawing out any earnings they might have? A. No.

Q. On account of their investment in the Western Construction Company?

A. No. There was no restriction on them. They could draw as they choosed. Some of them drew more and some of them drew less.

Q. In your case, do you know whether any of your children drew any substantial amounts?

A. Oh, yes.

(Testimony of Albin Johnson.)

Mr. Potts: I will have this marked for identification.

(Document above referred to marked Petitioners' Exhibit 11 for identification.) [197]

Q. (By Mr. Potts): Showing you this exhibit which is a copy of this book (indicating) will you tell the Court what that exhibit represents?

A. That is the money that they got invested in the company.

Q. Well, what is that? Tell the Court what that is—that exhibit.

A. It is a deposit slip from the bank.

Q. And for whose account?

A. For Winston and Elsie Keil.

Q. No, no. Whose account, who is credited there?

A. The Western Construction Company.

Q. And what are the two items there?

A. Winston Johnson, $10,000, and Elsie Keil, $10,000, or a total of $20,000.

Q. And the date of this slip?

A. May 7, 1942.

Mr. Potts: We offer, if the Court please, Petitioners' Exhibit 11 in evidence.

Mr. Payne: No objection.

The Court: Petitioners' Exhibit 11 will be admitted in evidence.

(Document heretofore marked Petitioners' Exhibit 11 for identification, received in evidence.) [198]

(Testimony of Albin Johnson.)

Q. (By Mr. Potts): Just to hurry your testimony along as much as possible, I am going to ask you what happened to you and Winston's, Vedola's and Elsie's interests in the Western Company—in the limited partnership.

A. As the Western Construction Company the last couple of years have not done very much work, we organized a new company, which we call the Glacier Construction Company, and I took the children in as a partner in that company.

Q. That is a partnership?

A. No, that is a corporation.

Q. And now, what interest did Winston, Elsie and Vedola have in the corporation, the Glacier Construction Company?

Mr. Payne: I should like to object to that. I do not think it has any material bearing in this case. It is after our taxable period, and it is after an investigation has been made by the Bureau of Internal Revenue. The position has been taken that the partnership itself was subject to tax, and I do not think that this is pertinent to any issue before the Court at this time.

The Court: What is the purpose of this, Mr. Potts?

Mr. Potts: The Petitioner would like to show, if the Court please, that Albin Johnson and the limited partners of his took the same interest that they had in Western [199] Construction Company and invested it in this corporation.

(Testimony of Albin Johnson.)

The Court: You mean that they withdrew from the Western Construction Company?

Mr. Potts: Yes, in 1947. And that they withdrew all of their earnings from there and invested it in the cash capital of this corporation.

The Court: And that they are no longer members of the Western Construction Company?

Mr. Potts: That is right.

The Court: Well, I will overrule the objection.

Q. (By Mr. Potts): Will you answer the question, Mr. Johnson? What became of you and your limited partners' interest in the Western Construction Company?

A .We transferred it over to the Glacier Construction Company, Incorporated.

Q. Now, with respect to the financial interest of Winston, Elsie and Vedola in Western Construction Company, a limited partnership, what became of that money?

A. It was—they bought stock with it in the Glacier Construction Company.

Q. In their own names?

A. In their own names.

Mr. Potts: I have here the stock book, if the Court please, and I would like to show it to Counsel, if I might. [200] Mr. Payne, do you want to look at these articles? If the Court please I should like to read into the record from the articles of incorporation of the Glacier Construction Company, Article 5, relating to the capital stock.

(Testimony of Albin Johnson.)

The Court: You may do that.

Mr. Potts: Article 5 of the articles of incorporation of the Glacier Construction Company, Incorporated, a Washington corporation, approved and filed in the office of the Secretary of State on March 7, 1947, provides as follows:

"The capital stock of this corporation shall consist of 125,000 shares of common capital stock, at $1.00 par value per share."

And then I should like to read into the record from the stock certificate book the stubs, 1 to 5 inclusive.

The Court: You may do so.

Mr. Potts: No. 1, for 10,000 shares, issued to Albin Johnson, March 12, 1947; No. 2, for 10,000 shares, issued to Rose Johnson, March 12, 1947;

No. 3 for 38,000 shares, issued to Winston Johnson, March 12, 1947;

No. 4, for 48,000 shares issued to Elsie J. Keil, March 12, 1947;

No. 5, for 9,000 shares, issued to Vedola J. Kent, dated March 12, 1947. [201]

Q. (By Mr. Potts): What was the reason for forming this corporation, Mr. Johnson?

A. Oh, to get—to do some work, and we wanted to get going and do some construction work again.

Q. Was the Western Construction Company, a co-partnership, doing any amount of construction work? A. No.

Q. Were you going to do the same kind of construction work in the corporation, the Glacier Con-

(Testimony of Albin Johnson.)

struction Company, as you did in the Western Construction Company?

A. That is it—the same thing—as we did before.

Q. The same type of work?

A. The same type of work—yes.

Q. And the same kind and size of buildings, and so forth?

A. Oh, that is hard to say. We thought first we were going to build a few houses, and then we may just go ahead and build some small houses to see how they will turn out.

Q. And now, those shares that I have read to you—was cash paid for those shares?

A. Yes.

Q. If you know, did Vedola, Elsie and Winston get the money—where, if you know, did they get the money to pay cash for their shares? [202]

A. Yes, they got the money to pay cash for their shares.

Q. Where?

A. They got it from the earnings that they earned from the money that they invested with the Western Construction Company.

Q. Can you tell the Court whether or not the certificates of those shares are in their possession?

A. Yes.

Q. How long did Winston work for the Western Construction Company?

A. Well, he worked—of course he worked for me before——

Q. (Interposing): I mean from the time that

(Testimony of Albin Johnson.)

he got out of the army, how long did he work for the Western Construction Company?

A. He worked down at Coulee Dam when we were there. He worked all the time when I went together with the other brothers since 1934. He has worked with me since then. During school vacations——

Q. (Interposing): He worked as a youngster for you? A. Yes, sir.

Q. I mean, when he separated from the Army and came to work as a limited partner, how long did he work?

A. He worked for the Western Construction Company all the time. [203]

Q. What kind of work did he do?

A. Well, he was estimating, and also supervising the work, like we had several jobs, and he really took care of them. He estimated them and took care of them, like the barracks for the Houghton job in Kirkland. And then at Pier 91 we had a couple of jobs down there that he supervised.

Q. Pier 91 in Seattle?

A. Yes. And the Service Flight Building in Renton, at the airport there. And the Gunnery Revetment.

Q. The Gunnery Revetment, you say?

A. Yes, sir. That was built for to shoot in the guns from the airplanes, you know, around the field there, you see.

Mr. Potts: Your witness.

(Testimony of Albin Johnson.)

Cross-Examination

By Mr. Payne:

Q. Mr. Johnson, you said that you lost a lot of money on the Coulee Dam job.

A. I surely did.

Q. How much did the partnership lose on that, do you know?

A. Oh, I don't know exactly of course now. Approximately around $100,000 I think it was.

Q. That was in 1935?

A. Yes. We started in 1934 and we finished the job in 1935. [204]

Q. What was the status of the partnership in 1935 and 1936—was it at a very low ebb?

A. Yes, we were pretty low after we got through there.

Q. You were not able to pay your obligations at that time, were you?

A. No, but we got some small jobs, and we finally got so that we began to pay off.

Q. Was the partnership itself insolvent at that time, do you know? A. What do you mean?

Q. Were your debts more than your assets at the Coulee Dam job?

A. Yes, I believe—I believe that if they would have gotten after us then they sure would really have broke us. I had some houses that I had put up as pledges, and my brothers had their homes which they had to put us as pledges, and that was

(Testimony of Albin Johnson.)

the only thing that we got credit on so that we could keep going.

Q. Mr. Johnson, you said that you took the children into the 1942 partnership in order to get additional assets, is that what you said?

A. That is it.

Q. What additional assets did you get?

A. Well, we got $20,000 more in notes.

Q. In notes? [205] A. Yes, sir.

Q. Did you give the children $20,000?

A. I didn't give it to them. I loaned it to them.

Q. You gave them checks for that amount of money? A. Yes. I loaned it to them.

Q. With the understanding that they would put it back into the Western Construction Company?

A. That they put it back—yes.

Q. And they did do that at your request?

A. That is it.

Q. And you were no richer or no poorer after that, were you?

A. Well, we had that much more credit. If we had that when we were down at Coulee Dam, we would have been okay.

Q. You mean the Western Construction Company had the credit, or you individually had the credit?

A. Well, I had the credit, and that is the same thing as the Western Construction Company, because when we signed for any bonds, we had to sign as individuals.

(Testimony of Albin Johnson.)

Q. And you used your own individual resources to finance the partnership?

A. Sure. That is the only money that we had.

Q. Outside of the stated capital in the partnership? A. Yes, sir.

Q. Do you know how much money you had in the partnership [206] as stated in the new agreement of 1942?

A. I cannot recollect the figures, no, but that would be——

Q. (Interposing): About $15,000, would it be?

A. The books would show that. I must have had more than $15,000.

Q. What makes you think that?

A. Well, if I loaned $20,000, I must have had more than $15,000. I had to have more—I could not loan away something that I didn't have.

Q. Would you say that you individually used personal assets in the business of the partnership after the signing of that first partnership agreement in 1942, in excess of $15,000?

A. Yes, sir.

Q. How much in excess of that would you say it was?

A. I don't know, but of course the books will show that. Of course I cannot recollect the figures.

Q. This deposit slip in evidence shows Winston Johnson $10,000, and Elsie Johnson $10,000. Is that money which they paid into the Western Construction Company at your request?

(Testimony of Albin Johnson.)

A. Yes. That is the money that they loaned from me, you see.

The Court: That you loaned to them? [207]

A. That I loaned to them, yes.

Q. (By Mr. Potts): And they paid that back into the partnership?

A. They paid that back into the partnership and they gave me a note for it.

Q. Have those notes ever been paid to you?

A. Yes, they have been paid now.

Q. When?

A. Oh, I think about a year ago, or maybe a year and a half ago.

Q. Was it in 1947 or in 1946?

A. In 1947 I think it was.

Q. What was Mrs. Keil's husband doing during 1942? A. He was a painter.

Q. He was a painter? A. Yes, sir.

Q. They had no property, did they?

A. No, I don't think so. I don't know.

Q. Do you know whether Elsie talked to her husband before she signed the note?

A. Oh, I am sure that she did.

Q. You don't know whether she did or not?

A. I am sure that she talked to him about it, yes.

Q. You said Vedola's husband—Mr. Kent—came back in 1942 and worked for the partnership—he came back from [208] the Army and worked for the partnership, is that right?

A. No, he never worked for the partnership.

Q. He never worked for the partnership?

(Testimony of Albin Johnson.)

A. No, he did not.

Q. I understood that he did.

A. Ellingson came back and worked for the partnership.

Q. Ellingson? A. Yes, sir.

Q. Is Mrs. Ellingson your daughter?

A. No. That is George's daughter.

Q. What kind of work did he do?

A. Carpenter work.

Q. And you paid him the same as any other employee?

A. I don't know how much he was paid, but I know that he was paid carpenter's wages anyway. And he was doing some supervising also. I do not know whether we paid him any more for that or not. I don't know about that.

Q. Now, in 1943 when Vedola came into the partnership, did you have a discussion among you about her interest? A. Yes.

Q. Did you tell the children what they ought to do? A. Well——

Q. (Interposing): Did you tell Winston and Elsie that they should transfer a part of their interests to Vedola?

A. Well, Vedola came of age, and I think it was more or [209] less agreed between themselves about that.

Q. You said that you told the children that they would have to pay the notes if anything happened so that it turned out bad, is that right?

(Testimony of Albin Johnson.)

A. Yes.

Q. You told them that before they signed the notes, did you? A. Oh, yes.

Q. You didn't expect that it would turn out that way, did you—that it would turn out bad?

A. Well, you can never tell, because contracting is the biggest gamble you ever undertook. Some of those jobs, like Holly Park, after we got going there, they froze the lumber for us, and they froze the nails. The government froze the lumber and froze the nails, and even though we had a government contract we could not buy lumber or nails, and we had a gang of 300 or 400 carpenters going, and we had to kind of lay them off—we had to lay them off. And we got into winter months where we got into mud and slush, and one thing or another. That job could have run away from us, and we could have lost all kinds of money.

Q. Do you remember when you took the Rainier Vista government contract? A. Yes, sir.

Q. What month was that? [210]

A. That was in 1942.

Q. What time?

A. I am pretty sure that we started that in the first part of August, 1942.

Q. Now, let me see, you finished the West Park contract late in 1941, didn't you? A. Yes, sir.

Q. Then what did you do after that?

A. I don't remember what job we had after that. I think that we had some warehouse that we worked on.

(Testimony of Albin Johnson.)

Q. You cannot remember the dates when you started those jobs?

A. The Alaska stock pile job, we started that, and then we started with the Rainier Vista, and that was in August of 1941 that we started on the Rainier Vista. I am not so sure on those dates. But those could be looked up if you want a record of them.

Q. Mr. Johnson, you did have some substantial partnership work in process at the time that this partnership was formed, in 1942, didn't you?

A. Yes.

Q. And you had a lot of equipment and had men working, and things were active at that time?

A. Well, we didn't have very much equipment. We rented most of the equipment. [211]

Q. I see.

A. We didn't have enough money to buy the equipment. If we could have done that,—we could have bought the equipment, we could have made some real money.

Q. But your West Park project had been very successful, hadn't it?

A. Well, it could have been awfully bad, too. If you could have seen what we had to go through there, you would realize that it could have been awfully bad, too. We have a movie picture. I wish I could show you that movie picture, where mud is up to knee high, and we had to drag that lumber through that mud, and when we dragged it through that mud, you should have seen the carpenters, how

(Testimony of Albin Johnson.)

they tried to handle that lumber. And there were lots of them that quit on account of that and went home.

Q. But you made money in spite of that?

A. Well, we got an addition to it, and we got nice weather, and when we got the nice weather we could get in with materials and equipment. We were actually losing money there in the beginning. Mind you, the lumber cost us $58.00 a thousand, place lumber, when we first started in there.

Q. And this loan that you made to your children, you expected to do them a great favor by it, didn't you?

A. It might have turned out to be a lemon, too.

Q. What did you intend to do by it? Did you intend to [212] do them a great favor by it?

A. I was intending to get them into the construction business. My boy had been working with me since he had been able to carry a water bucket. When I started in, we didn't have any office, and my girl was doing all the typing and all that stuff in the evenings, because in the daytime I was on the job.

Q. But you did not expect the girls to go to work in the partnership, did you?

A. Yes. She could have worked for us.

Q. Well, Elsie was married in 1942, wasn't she?

A. Yes, but she could have worked for us.

Q. Did she have a child?

A. She had a child, yes.

Q. You didn't expect her to work for the part-

(Testimony of Albin Johnson.)

nership, did you? A. Well, she surely could.

Q. I don't hear you.

A. Well, she surely could if she wanted to.

Q. But you didn't expect her to?

A. Well, if we really needed her, why she would have come to work. Like in the organization we have now, I expect to have my wife come down and work in the office when we get started in this new corporation.

Q. Did you ask Elsie to work in the [213] partnership?

A. Well, if we really needed her we would.

Q. I didn't ask you that. I asked you, did you ask Elsie to work in the partnership?

A. I don't know whether I asked her or not. I know that if we really needed her and asked her to come, why she would come.

Q. You never asked any of the other girls either, did you, in 1942 or later?

A. We had lots of girls that worked up there in the office and, sure, Elsie, before she was married, she was working for the Western Construction Company, and she was working down at Coulee Dam, and was working with me down there.

Q. But you never expected the girls to work in construction work with you, did you?

A. Yes, I did, and they are liable to come to work for me now, too.

Q. Well, you never asked any one of them to come and work for you during 1942, 1943, 1944 and 1945, did you?

(Testimony of Albin Johnson.)

A. Oh, I don't remember how that was. I think I asked Vedola to come to work. I don't remember what it was now. She was going to some kind of a business school, or whatever it was, so she didn't come at that time, but we need stenographers, and we needed people to work for us.

Q. You said that the children drew substantial sums [214] from the partnership? A. Yes.

Q. Do you know what they used those sums for?

A. No, I don't know what they used them for.

Q. You think that most of it was used to pay their federal taxes, do you?

A. No. Some of us paid for that. Maybe to buy groceries, and buy clothes, and one thing or another.

Q. You are just assuming that, aren't you?

A. I know that they did buy those things.

Q. Do you know that they got any more than their tax money in 1942?

A. Yes, they got more than their tax money in 1942.

Q. How much more?

A. I don't know whether it was 1942, but it was later on, I know, that they drew all kinds of different amounts. I don't know how much. The record will show that, how much money they drew, but they don't draw just for tax money purposes.

Q. How did it happen, when you came to form the corporation in 1947, that you took only 10,000 shares?

A. I don't know really how that happened. I will tell you, I would like to get the children started

(Testimony of Albin Johnson.)

in this business, and get my son at the head of it, because in four or five years from now I would like to see them be going in [215] good shape so that I just can leave it to them and let them have it.

Q. Do you remember how much Elsie had in the new corporation—how many shares?

A. I have forgotten now. It was just read here.

Q. 48,000 shares, wasn't it? A. Yes, sir.

Q. How do you explain that she got 48,000 shares and you only took 10,000? What was the reason for that?

A. There was no reason at all. I can buy in any time that I want to—I can put some more money in it if I want to. There was absolutely no reason for it at all.

Q. How does it happen that she has more stock than Winston? Do you know the reason for that?

A. That is according to the earnings.

Q. How is that?

A. That is according to the earnings, or the investment, I guess. The books will also show how that happened.

Q. But when you formed the corporation you just took yourself and your three children out of the partnership and went in business as the Albin Johnson family? A. And my wife.

Q. And your wife? A. Yes, sir.

Q. Now, you have said that Winston was an estimator? [216] What is an estimator?

A. An estimator takes the quantities off of the plans.

(Testimony of Albin Johnson.)

Q. Would he estimate a job like the Rainier Vista job? A. Yes, sir.

Q. Would you take his judgment on that in signing a contract for a million dollars?

A. Yes, I would.

Q. Did he do that?

A. He was in the Army at that time when we figured Holly Park, but he figured lots of jobs—estimated lots of jobs, and naturally going back——

Q. (Interposing): Beginning when—beginning what year?

A. Oh, he had been working a long time with us.

Q. He was just doing office work in 1942, wasn't he?

A. He was doing office work in 1942, yes, but also he was working as a foreman on one job.

Q. What kind of a foreman?

A. Carpenter foreman. He worked as a carpenter foreman in Rainier Vista.

Q. In 1942?

A. Until he was called into the Army.

Q. In 1942?

A. No. That was in 1941. I am sure that we started Rainier Vista in 1941—in the Fall. [217]

Q. Did you pay him a little extra as a carpenter foreman, or was he just being paid as a carpenter then?

A. I don't remember what he was paid, but then when he came back from the Army he came into the office and started estimating. That was his education, and being with me all the time, and showing

(Testimony of Albin Johnson.)

him how to estimate it, and how we took it off and one thing or another, why naturally—well, he is educated, having gone to school, and he is good on figures and he can read the plans, having got that education in school and also by experience working with me.

Mr. Payne: That is all.

Mr. Potts: That is all.

(Witness excused.)

Whereupon,

LLOYD W. JOHNSON

called as a witness for and on behalf of the Petitioners, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Potts:

Q. State your full name.

A. Lloyd W. Johnson.

Q. Where do you reside, Mr. Johnson?

A. 5515 Penrith Road, Seattle.

Q. Mr. Johnson, how long have you lived in Seattle? [218] A. All my life, since 1910.

Q. You are, aren't you, the son of George Johnson? A. Yes, sir.

Q. Who has preceded you on the stand?

A. Yes, sir.

Q. Lloyd, what has your education been?

A. I was educated as a civil engineer at the University of Washington.

(Testimony of Lloyd W. Johnson.)

Q. Before you went to the University of Washington had you engaged in any of the construction business—I mean, had you worked any in the construction business?

A. I have worked in the construction business all my life, ever since I was old enough to carry a water pail.

Q. What was your first job?

A. My first job was that of water boy at the Shafer Building.

Q. That is the building at the corner of Sixth and Pine here in Seattle? A. Yes, sir.

Q. And did you continue on from that early age until you went to the University—did you continue on in the construction business?

A. Yes. I worked every summer and during the holidays and vacations on different jobs that the Western Construction Company had. [219]

Q. Now, Mr. Johnson,—now, Lloyd, directing your attention to what has been testified to here as the Coulee Dam job, did you have anything to do with that job?

A. Yes. I worked on that job from the time it started until I got sick.

Q. You had some ill health then about the time that the Coulee Dam job finished, did you not?

A. Yes. I got T.B. over at Coulee Dam and I had to be in a hospital for a year.

Q. After you got out of the hospital—after this Coulee Dam job—did you continue on in the construction business? A. Yes, I did.

(Testimony of Lloyd W. Johnson.)

Q. What kind of work did you do, and who for?

A. I worked—right after I got well—that is, arrested you might say with this case of T.B., I did work for a short while in the King County Engineer's Office.

Q. That is here in Seattle?

A. That is here in Seattle.

Q. Yes.

A. And then after that through a connection at the University, I became acquainted with Max J. Kuney, of Spokane.

Q. When did you first become acquainted with Mr. Kuney—when you first became acquainted with him, what kind of work was he engaged in? [220]

A. He was engaged in building the dam.

Q. Where was that?

A. To correct some of the other testimony, it was Island Park, Idaho. It was right in there, in the crook of Montana. That is why they speak of it as Montana.

Q. Oh, I see. How long were you over there?

A. I was there approximately a year as assistant superintendent.

Q. And after that, Lloyd, where did you go?

A. I came back to work for the Western Construction Company.

Q. Doing what?

A. I worked out at the swimming pool, at the University. That is the addition to the men's athletic pavilion.

(Testimony of Lloyd W. Johnson.)

Q. At the University of Washington?

A. Correct.

Q. Directing your attention to the year 1941, did you become associated with Mr. Kuney again in that year?

A. Yes, I did. I became associated with Mr. Kuney—although I hadn't worked for him since 1937, he had remained a personal friend of mine, and he had spoken several times on visits to Seattle that perhaps we should go into some kind of a deal and bid on a few jobs. We did on a few jobs, and we were unsuccessful. And finally we bid on a job in the [221] Navy Yard at Bremerton. That job at the Navy Yard started out as a $142,000 contract, and in 1941 we were just in the middle of the job when Pearl Harbor was attacked—when the attack on Pearl Harbor took place—and the Navy evidently was satisfied with our work, and they negotiated several jobs in that immediate vicinity with us.

Q. By "negotiated," you mean that you did not bid on them?

A. We did not bid on that particular batch of work.

Q. Now, with respect to the limited partnership of the Western Construction Company begun in 1942, what was your connection with the limited partnership—that is, how did you happen to go into it, will you tell the Court?

A. Well, this was discussed with my father, about the forming of this limited partnership, and we discussed how we could borrow the money from

(Testimony of Lloyd W. Johnson.)

him and sign a note, and we would then be limited partners in the Western Construction Company.

Q. Now, at that time, as I understand your testimony, you already had this first job with Kuney pretty well completed, is that correct?

A. Yes, we did.

Q. And had you made money on that job?

A. Yes, we had.

Q. With respect to this note of $10,000, had you made [222] that?

A. Yes, and considerably more than that.

Q. And did you understand from any conversation with your father that this note was not under circumstances to be paid?

A. No, there was never any discussion about anything like that. We signed notes, and we sign notes in our Kuney-Johnson business large sums of money, and we know what we have to do when we sign a note.

Q. Now, at that time did you or did you not have an interest in the estate—in an estate being probated here in King County?

A. Yes. I have had that interest all the time.

Q. And would you tell the Court whose estate it is?

A. It was the estate of my mother, who died in 1920.

Q. Do you know whether, or can you tell us whether in those conversations with your father, and leading up to the formation of this limited partnership, there was anything about your being actively engaged in the limited partnership?

(Testimony of Lloyd W. Johnson.)

A. Well, during the time that I was with Kuney we were, of course, bidding on jobs all the time—we were bidding on several jobs a week, you might say, and sometimes we would bid on one, and sometimes we might bid on two. We were doing quite a bit of work, and we were aware of the costs and the increase in the cost of building. And I [223] was aware at all times that I had this interest in the Western Construction Company, and at all times when jobs were being prepared to bid upon, I was called in for any kind of consultation or advice, and whenever there was any need for any kind of consultation or advice, why I was there.

Q. Well, I didn't mean that, Lloyd. I will get to that later. Let me put it this way. In your discussions with your father about the formation of the limited partnership, can you tell us whether or not there was anything in the discussions relative to your returning and giving full time to the Western Construction Company?

A. Well, yes, there were discussions about my returning. There has always been discussions about that. Ever since I was 5 years old it seems like I heard how Roy, I and Winston were going to take over the Western Construction Company.

Q. Now, Mr. Kuney was not a graduate engineer, was he? A. No.

Q. And as I understand from former testimony on the stand, neither had he been engaged in general construction—that is, in building?

(Testimony of Lloyd W. Johnson.)

A. No, that is correct.

Q. In the erection of large buildings, bridges, and so forth? A. That is correct. [224]

Q. What had been his work?

A. His principal work had been dirt work—dirt moving.

Q. I will ask you whether or not Kuney was a man of some means?

A. Yes, of considerable means.

Q. So that your position with him at that time was rather an enviable one? A. I think so.

Q. What was your age at that time, Lloyd—in 1941? A. 31 years old.

Q. 31 years old? A. Yes, sir.

Q. Now, to go back to the other question that you gave us the answer on, you might detail what assistance you gave the Western Construction Company while you were with Kuney.

A. The assistance I gave them was in the final preparation of bids on large projects. It was not work that was done at 8 o'clock in the morning or at 12 o'clock at noon. It was done at any hour of the day, and in any place. There were not any particular hours concerning that work. It was just whenever—whenever they were going to get a job ready to bid on, why, if it was a large job, I would be consulted as to the prices and the present or the future prices of material. [225]

Q. Referring now to 1943 and the formation of what we call here the second limited partnership, will you tell the Court how that partnership came

(Testimony of Lloyd W. Johnson.)

about as far as your particular family was concerned? That is, there was a division of interest, was there not—a division of your own interest?

A. Yes, there was.

Q. In the Western Construction Company?

A. Yes. In the original limited partnership I had invested $10,000, and at a later date it was discussed that—or a later date why Rachel at that time was willing to take the risk in this investment, and so we discussed it among ourselves and we agreed that the way that we should do it was for me to reduce my investment to $5,000 and have her to increase hers to $5,000, or have her come in for $5,000.

Q. And how did you do that? I mean, physically. What were the mechanics of it?

A. Well, the mechanics of it were that we just took a note for $5,000 in place of the $10,000 note.

Q. Lloyd, the reason I asked you that is this, can you tell us whether you have the original $10,000 note? A. I don't know, until I look.

Q. We haven't been able to find it. Will you look tonight and see if you can locate it?

A. Yes, I will look. [226]

Q. Now, did you withdraw from the partnership any earnings—I am talking of the partnership in the Western Construction Company—any earnings as they accumulated? A. Surely.

Q. Can you give us any idea as to the amounts you may have withdrawn at any time? Just a minute, I think that we can assist you on that. We

(Testimony of Lloyd W. Johnson.)

have prepared, if the Court please, a schedule of the investments; the share of the profits and the withdrawals, supported by the checks, which I would like to have Counsel examine. First of all, I will have this marked for identification.

The Court: Mark that for identification Petitioners' Exhibit No. 12.

(Document above referred to marked Petitioners' Exhibit 12 for identification.)

Q. (By Mr. Potts): Showing you Petitioners' Exhibit 12 marked for identification, have you had occasion to go over that exhibit?

A. Yes, I have.

Q. Will you tell us what that exhibit is?

A. Well, this exhibit is a statement of my original investment; and my earnings and my withdrawals.

Q. And referring to the checks up here, can you tell us what those are?

A. These checks are the checks that have been issued [227] to me for withdrawals from the company.

Mr. Potts: We would like to offer Petitioners' Exhibit 12 in evidence, if the Court please.

Mr. Payne: That covers what years, Mr. Potts?

The Witness: It covers several years.

Mr. Potts: This covers 1942, 1943, 1944, 1945 and 1946.

Mr. Payne: We have no objection to anything up through 1945. We see no materiality to any withdrawals after that date.

(Testimony of Lloyd W. Johnson.)

The Court: Well, it has always been my ruling, where the Commissioner is contesting the validity of a partnership—it has always been my ruling that it is a very essential thing to show that the partnership was lived up to by actually distributing the profits of the partnership, not only in the years that are before us, but any subsequent years. The purpose of that is so that would show that it was not a mere sham, and I have always committed the withdrawals right up to the date of the hearing as showing the bona fides of the transaction. So I will overrule the objection, and it will be received as Petitioners' Exhibit 12.

(Document heretofore marked Petitioners' Exhibit 12 for identification received in evidence.)

PETITIONERS' EXHIBIT No. 12

Lloyd Johnson

Jan. 1, 1942, to Dec. 31, 1945

5-12-42	Investment	$10,000.00
12-31-42	Share of profits	35,615.92
6-30-43	6 mos. profits	17,919.80
6-30-43	Reduction on investment	5,000.00
12-31-43	6 mos. net profit	5,788.62
1-13-44	Return	3,600.00
12-31-44	Share of profit	2,075.25
12-31-45	Share net profit	5,693.74
		$75,693.33

(Testimony of Lloyd W. Johnson.)

Withdrawals		
3-13-43	Personal withdrawal	6,000.00
6-15-43	Personal withdrawal	6,500.00
9-13-43	Personal withdrawal	6,000.00
12-20-43	Personal withdrawal	7,500.00
4-10-44		350.00
5-16-44	Coll. of Int. Rev.....	399.50
5-16-44	Coll. of Int. Rev.....	4.00
5-16-44	Coll. of Int. Rev.....	400.91
5-16-44	Coll. of Int. Rev.....	4.01
9-13-44		350.00
1-11-45		350.00
3-19-45		3,000.00
6-15-45		850.00
7-25-45		2,000.00
		$33,708.42
Brought forward		$75,693.33
12-31-46	Share net profit	21.16
		$75,714.49
Withdrawals		
Withdrawals brought forward		$33,708.42
1-15-46		4,000.00
5-28-46		200.00
6-20-46		9,000.00
		$46,908.42

Admitted May 24, 1948.

The Court: It is now ten minutes after 6. We will [228] adjourn for the day to 9 o'clock tomorrow morning, May 25.

(Whereupon an adjournment was taken at 6:10 o'clock p.m., May 24, 1948, to 9 o'clock a.m., May 25, 1948.) [229]

May 25, 1948

The Court: You may now proceed, Mr. Potts.

Mr. Potts: Will you take the stand again, Lloyd?

Whereupon,

LLOYD W. JOHNSON

a witness called on behalf of the Petitioners, resumed the stand for further examination, having been previously sworn, and was examined and testified as follows:

Direct Examination
(Continued)

By Mr. Potts:

Before I proceed with the examination, if the Court please, with regard to Petitioners' Exhibit 12, we discovered that the checks for 1946, while listed on the exhibit, were not attached, and we found three checks, one in the sum of $9,000, and one in the sum of $200, and one in the sum of $4,000, which support the items set forth on page 2 of this schedule, which we would like at this time to have added—these three checks added to the checks on the exhibit.

Mr. Payne: No objection.

(Testimony of Lloyd W. Johnson.)

The Court: Very well. They will be added to the exhibit.

Mr. Potts: Also, at this time, if the Court please, we should like to have marked for identification and introduced into evidence the affidavits of publication of two certificates of the formation of the limited partnership. The first one I think should be 13, and the next one should be 14. [232]

The Court: They will be marked for identification as Petitioners' Exhibits 13 and 14.

(The documents above referred to, marked Petitioners' Exhibits 13 and 14, respectively, for identification.)

Mr. Payne: We have no objection if you want to put them in evidence.

Mr. Potts: All right. Then we will offer them in evidence.

The Court: All right. They are received as Petitioners' Exhibits 13 and 14.

(Documents previously marked Petitioners' Exhibits 13 and 14, respectively, for identification, received in evidence.)

Q. (By Mr. Potts): Lloyd, how did you come out in your adventure with Mr. Kuney—your business adventure, I mean?

A. I came out very well.

Q. And we will have a stipulation with Counsel for the Commissioner regarding your expenses with Kuney and Johnson, which were a part of this case,

(Testimony of Lloyd W. Johnson.)

because they were assessed on your tax return here.

A. Yes, I understand that.

Mr. Potts: That is correct, isn't it?

Mr. Payne: What is that? [233]

Mr. Potts: That we will have a stipulation regarding Mr. Lloyd Johnson's expenses.

Mr. Payne: You may have it right now if you wish it.

Mr. Potts: Will you dictate that into the record?

Mr. Payne: Yes, I shall be happy to do that. For purposes of the record, the parties are now willing to stipulate that in addition to the amounts of expenses allowed to Mr. Lloyd Johnson, which also affects the case of his wife, Roberta Johnson, he is entitled to additional allowances over those shown in the deficiency notices, of $1,200 for the year 1942; $1,200 for the year 1943; $1,200 for the year 1944, and $600 for the year 1945. And that all of the remaining amounts of such expenses disallowed in the deficiency notices are accepted as being properly disallowed.

Mr. Potts: Is that correct, Lloyd?

The Witness: Correct.

Mr. Potts: We will so stipulate.

The Court: Very well. That stipulation then is in the record as the agreement between the parties as to the matter stated.

Q. (By Mr. Potts): Now, showing you Exhibit 12, Lloyd, I think you have heretofore identified that as a statement of your investment in the part-

(Testimony of Lloyd W. Johnson.)

nership, your share of the profits and your withdrawals. [234] A. Yes, sir.

Q. Can you tell the Court approximately the amount of your withdrawals in the year 1943? You might just read them off from there. 1943, 1944, 1945 and 1946.

A. Okay. I withdrew 3-13-43 the first withdrawal of $6,000;

I withdrew 6-15-43 $6,500;

I withdrew 9-13-43 $6,000;

I withdrew 12-20-43 $7,500;

I withdrew 4-10-44 $350;

I withdrew 5-16-44 $399.50;

I withdrew 5-16-44 $4;

I withdrew 5-16-44 $400.91;

I withdrew 5-16-44 $4.01;

I withdrew 9-13-44 $350;

I withdrew 1-11-45 $350;

I withdrew 3-19-45 $3,000;

I withdrew 6-15-45 $850;

I withdrew 7-20-45 $2,000;

I withdrew 1-15-46 $4,000;

I withdrew 5-28-46 $200;

I withdrew 6-20-46 $9,000.

Q. Did you employ estimators in your work with Kuney and Johnson?

A. Yes, I did, and I do. [235]

Q. You do, you say? A. Yes, sir.

Q. What is your position with Kuney and Johnson at the present time?

A. I am a general partner.

(Testimony of Lloyd W. Johnson.)

Q. And who has the superintendence—the general superintendence over building construction in Kuney and Johnson? A. I do.

Q. Do you employ estimators?

A. Yes, I do.

Q. During the years 1943, 1944 and 1945, can you tell the Court what was the usual going salary for estimators in this community doing the type of work that, say, Mr. Winston Johnson was doing, and Mr. Roy Johnson was doing for the Western Construction Company?

A. We pay our estimators at the present time about $150 a week, but we have one estimator who works for us by the name of Mr. Clagen, who not only does estimating for us, but after he estimates a job he goes out and follows through on the job and buys the material and supervises it, and we pay him $150 a week minimum, but we give him a percentage of the jobs that he goes out to do. Last year he made—oh, I don't know—we did a job down at Astoria for the Navy that he made about $30,000 on. [236]

Q. You allow a sort of a commission on top of their salary, is that it?

A. With that particular man.

Q. With that particular man? A. Yes.

Q. But I mean on your average estimator, what would be the usual and reasonable going wage?

A. From $125 to $150 a week.

Q. Now, how would that wage compare to the

(Testimony of Lloyd W. Johnson.)

years—how would that wage—that is the wage now, as I understand it. A. Yes.

Q. How would that wage compare with the wage, say, during the war?

A. About the same all through the war.

Q. About the same?

A. Yes. Estimators were difficult—very difficult to get. That is, to get a man that you could put your confidence in. There are very few men to do that work. It is a difficult job to do, and it takes a long experience record before you can let somebody get into your plans and make up a bid for a large job, where you have to put up a certified check or you have to put a bidder's bond. When you bid these jobs, you lay all your chips on the table at once. You just don't play for small stakes. [237]

Q. Now, Lloyd, were you familiar with the work that Winston Johnson and Roy Johnson were doing for the Western Construction Company during the years 1942 and 1943, 1944 and 1945?

A. Yes, I was familiar with that.

Q. I am sorry. 1944 would be the end, as I recall the testimony, of Roy Johnson, but Winston then continued into 1945.

A. They were doing work very much similar or exactly similar to the work that I have just been speaking about.

Q. Do you know whether, in addition to the estimating, they did anything further with respect to the estimates?

A. I know that they at various times went out

(Testimony of Lloyd W. Johnson.)

on the jobs after the jobs were obtained and ran the job and obtained material and supervised the construction.

Q. Now, Lloyd, did I ask you last evening, after you went with Kuney-Johnson, what services if any you performed for the Western Construction Company? A. I believe you did, Ralph.

Q. I was not sure. Your witness. May I ask just one more question?

The Court: Yes.

Q. (By Mr. Potts): You had a note missing yesterday—your note I believe, and you found it last night, did you? [238]

A. Yes, I found it down at my office.

Q. And you gave it to me this morning?

A. Yes.

Mr. Potts: You may examine.

Cross-Examination

By Mr. Payne:

Q. Mr. Johnson, you testified that you worked for Mr. Kuney along about 1937 and 1938, is that right? A. That is correct.

Q. Was that on the Montana job?

A. Yes. I corrected that yesterday. I said that it was the Idaho job.

Q. And then you came back to the Western Construction Company? A. Yes, I did.

Q. What year?

A. I came back—it was the Fall and Winter of 1937, I believe.

(Testimony of Lloyd W. Johnson.)

Q. And how long did you remain?

A. I remained on that job for about a year—a little over a year, I guess.

Q. Then what did you do?

A. Then I worked for a short time for the General Construction Company.

Q. Who are they? [239]

A. They are the largest contractors in Seattle. In fact, the largest contractors in the Northwest. The reason I went to them was to gain experience. You go to college and you learn a lot of things out of a textbook, but I had a chance to go for a short time and work for a large construction company, and I felt that that was just as vital as going to school in my particular case, and I took it, and I worked for them a year and a half.

Q. Beginning in 1938 then?

A. I think in 1938.

Q. And continuing how long; through 1939?

A. Yes. 1938 and 1939.

Q. Then what did you do?

A. I came with them over and built the Seattle Tacoma Shipyards down on Harbor Island.

Q. When you say, "With them," whom do you mean?

A. With the General Construction Company.

Q. The Western Construction Company?

A. The General Construction Company.

Q. Oh, the General Construction Company?

A. Yes, sir.

(Testimony of Lloyd W. Johnson.)

Q. And you terminated your employment with about what date? A. I am not sure.

Q. In 1940 or 1941? [240]

A. I think it was in 1941.

Q. And then what did you do after that?

A. Well, it was about that time that I began to get interested with Max Kuney, and Mr. Erickson of the West Coast Construction Company had died, and I spent some time there settling his jobs that were still running and settling his estate, and at the same time doing some odd jobs, or bidding with Kuney. And at the termination of that all came in together there.

there.

Q. Did you enter into a partnership with Kuney?

A. Yes.

Q. What time—1940 or 1941? A. 1941.

Q. Was that early in the year, or do you remember?

A. Oh, I don't remember just when it was in 1941.

Q. Was that an equal partner? A. 50-50.

Q. And that partnership was continued down to the present time? A. Yes, sir.

Q. Were Kuney's offices and place of business then in Spokane? A. That is correct.

Q. How long did that continue?

A. Oh, he still has an office in Spokane. [241]

Q. And you opened offices in Seattle later?

A. We opened offices in Seattle as soon as we got any work here.

Q. I see. Now, do you remember discussing with

(Testimony of Lloyd W. Johnson.)

your father and with J. A. Johnson and Albin Johnson, and with Winston and with Roy the matter of organizing a partnership back in 1941?

A. I don't know the date, but I know that we have discussed that—not only once, but many times. Over a period of years that has been going on.

Q. Do you remember forming a partnership or instituting a partnership agreement in 1941 prior to this limited partnership before the Court?

A. No. When we dissolved the corporation and gave up our stock, it was then understood that we would be partners in the Western Construction Company.

Q. Do you know when you dissolved the corporation? A. Not the exact date—no.

Q. I show you a document and ask you if you have seen that before.

A. Yes, I have seen this. Sure. I have seen that. That is my signature.

Q. Do you recognize the signatures of all the signers of that document?

A. I recognize my own, and my dad's and I recognize [242] J. A.'s.

Q. Now, I will ask you again if that refreshes your memory that there was a discussion of a partnership in 1941? A. Yes, that is right.

Q. And you purported to form one?

A. Yes.

Q. What became of it?

A. Well, this partnership was in effect until the limited partnership started, I guess.

(Testimony of Lloyd W. Johnson.)

Q. You did not render any services under that partnership, did you? A. In 1941?

Q. Yes.

A. I was in Seattle, and I was working in the Western Construction Company's office many times during each week.

Q. Where did you purport to get the investment in that partnership?

A. From the corporation.

Q. Do you know what interest you had in the corporation?

A. I was president of the corporation.

Q. Where did you get your stock in the corporation? A. I got this stock from my father.

Q. He just put it in your name?

A. Yes. That is what I understood.

Q. And you understood that it belonged to [243] him? A. Yes.

Q. Then was there a discussion about this partnership in connection with the formation of the limited partnership in 1942 and the re-alignment of interests in the later partnership?

A. Yes, it was all discussed, how we would go from this into the limited partnership.

Q. Did you advise your father and the others that you were intending to continue your relationships with the Kuney-Johnson partnership?

A. I don't know whether I am going to be in business with Max Kuney tomorrow. I am in a partnership with Max Kuney now, and as soon as the partnership disagrees, the partnership is ended. And

(Testimony of Lloyd W. Johnson.)

what I intended to do in 1940—1941—I didn't have that foresight.

Mr. Payne: We should like to offer this document in evidence, Your Honor, for the purpose of showing——

Mr. Potts (Interposing): I have no objection.

Mr. Payne (Continuing): ——another successful attempt to form a partnership.

Mr. Potts: Now, I object to the comment of Counsel. I have no objection to the introduction of the document or the articles here, and I will get you another copy.

Mr. Payne: All right.

The Court: What is that instrument, you [244] say?

Mr. Potts: Articles of co-partnership between the three sons and the three general partners—that is, the three general partners now of the limited partnership.

The Court: Yes.

Mr. Potts: We have referred, as Your Honor will remember, to this after the dissolution of the corporation.

The Court: Yes.

Mr. Payne: I do not think that that is offered. Under the record as it now exists it shows that the corporation dissolved in 1942, and this is a 1941 partnership.

The Court: This will be referred to as Respondent's Exhibit C.

(Testimony of Lloyd W. Johnson.)

(Document above referred to received in evidence as Respondent's Exhibit C.)

RESPONDENT'S EXHIBIT C

Articles of Co-Partnership

This agreement made and entered into this 6th day of January, 1941, by and between J. A. Johnson, George Johnson, Albin Johnson, Roy W. Johnson, Lloyd W. Johnson, and Winston Johnson, in consideration of the mutual promises to be kept and performed by each of the parties hereto, the said parties agree as follows:

That Whereas the above-named J. A. Johnson, George Johnson, and Albin Johnson, since April, 1934, have been doing business as a co-partnership under the name and style of the Western Construction Company and have also been interested in, as majority stockholders, in the Western Construction Company, Incorporated, a Washington corporation, and

Whereas, Roy W. Johnson, Lloyd W. Johnson and Winston Johnson are the sons of J. A. Johnson, George Johnson, and Albin Johnson in the order named, and

Whereas, Roy W. Johnson and Lloyd Johnson were the owners of a substantial stock interest in said Western Construction Company, Incorporated, and relinquished said stock interest to their respective fathers upon their promise that they would be

(Testimony of Lloyd W. Johnson.)

given an interest in this partnership now being formed, and

Whereas, Winston Johnson, the son of Albin Johnson, has now reached his majority and has given up his college career to enter the construction business and work with his father, and

Whereas, it is the desire of the said J. A. Johnson, George Johnson, and Albin Johnson to have their respective sons, all of whom have been educated and trained in the construction business, to become associated with them in the construction business,

Now Therefore, it is agreed by and between the said parties first above named that said parties form as of this date, a co-partnership, with each party having an equal interest in said partnership from this date forward, provided, however, that the assets of the partnership shall be subject to the following accounting and division: during the period from the beginning of the Western Construction Company, a co-partnership up to April, 1934, the assets, it is admitted and agreed by all parties hereto, belong to J. A. Johnson and George Johnson, exclusively. From April, 1934, up and to the date of the execution of these articles of co-partnership, the increase in assets of said co-partnership, it is agreed herein, belong solely to J. A. Johnson, George Johnson and Albin Johnson, and from this date forward any increase in the assets of said corporation shall belong to the six parties first named herein share and share alike.

(Testimony of Lloyd W. Johnson.)

That the duration of this co-partnership shall be for a period of twenty-five (25) years from date hereof.

That the business to be carried on by the co-partnership is that of a general construction business with main offices in the city of Seattle, State of Washington.

That each of the six parties agree to actively further the interest of said co-partnership and to work together in harmony.

That said J. A. Johnson, George Johnson, and Albin Johnson shall receive out of the earnings of said co-partnership a salary to be agreed upon each year by the partners herein, which salaries are to be deducted from the earnings of the co-partnership before any division is made to the six partners, and Roy W. Johnson, Lloyd Johnson, and Winston Johnson are to receive such compensation as foreman, superintendent, and engineers employed by the partnership receive, until such time as said Roy W. Johnson, Lloyd W. Johnson and Winston Johnson are able to carry on the executive work now being done by their respective fathers, at which time their salaries are to be proportionately increased.

That after the said annual salaries have been paid to J. A. Johnson, George Johnson and Albin Johnson, and all of the operating expenses have been paid for the year, the balance of the net earnings of the partnership shall be distributed pro rata among the six partners hereinto, share and share alike.

In Witness Whereof, the parties hereto have set

(Testimony of Lloyd W. Johnson.)

their hands and seals the day and year first above written.

Witnesses:

/s/ J. A. JOHNSON,

/s/ GEORGE JOHNSON,

/s/ ALBIN JOHNSON,

/s/ LLOYD W. JOHNSON,

/s/ ROY W. JOHNSON,

/s/ WINSTON A. JOHNSON.

Admitted May 25, 1948.

Q. (By Mr. Payne): Mr. Johnson, you testified that you gave your father a $10,000 note along in 1942? A. That is correct.

Q. Did he give you some money previous to that?

A. I borrowed the money from my father.

Q. Did he give you a check for the amount of money that you borrowed? A. Certainly.

Q. And did you deposit that in your own account? A. I don't remember that now. [245]

Q. You don't know how you actually handled the transaction?

A. I know that I got the money from him, and I gave him a note for $10,000.

Q. And then you put that same amount of money back into the Western Construction Company, did you? A. That is correct.

(Testimony of Lloyd W. Johnson.)

Q. He instructed you that that was the purpose of it, and that was what you were to do with it?

A. It was understood—surely.

Q. Did you pay that $10,000 note?

A. The note was turned in, and I was given a $5,000 note in its place.

Q. In the subsequent year? A. Yes, sir.

Q. Did you pay the $5,000 note? A. Yes.

Q. When?

A. I don't know that either. I paid that, I think, in 1946.

Q. You knew that you had a large amount of stated partnership profits in 1942, didn't you, Lloyd?

A. Surely.

Q. How much was that?

A. $40,000, wasn't it? [246]

Q. I show you Petitioners' Exhibit in evidence No. 12, and I will ask you to refresh your memory as to the amount of your stated partnership profits that year. A. $35,615.92.

Q. Why didn't you pay your $10,000 note at that time?

A. Oh, I don't know. I have another note—I borrowed $2,500 from my aunt—Mrs. Victoria Erickson. I still owe her that money, and I never paid her that, and I still pay her interest on that, because she wished me to do that, and that is the way I am doing that.

Q. You knew that interest was running on the note due your father, didn't you?

A. That is right.

(Testimony of Lloyd W. Johnson.)

Q. And you did not withdraw all your stated profits from the partnership, did you?

A. No.

Q. Did they pay you interest on the amounts left in there? A. No. Why should they?

Q. In your business with the Kuney-Johnson partnership in 1942, 1943 and 1944, were you borrowing money for your operations?

A. We borrow money sometimes, and sometimes we do not. It depends on—we run our Kuney-Johnson Company—I will have to explain this to you. We use the Max J. Kuney Company [247] in Spokane as a bank and we draw all our checks on the Max J. Kuney Company in Spokane, and the only time that we borrow money as the Kuney-Johnson Company is when Max Kuney runs out of money in Spokane, and then we borrow money.

Q. You could have used this $35,000 in your Max Kuney business, could you not? A. No.

Q. You didn't have any use for it?

A. No, I didn't have any use for it.

Q. How is that?

A. I didn't have any use for it in the Max Kuney Company.

Q. Weren't you borrowing money in 1942 to run your contracts?

A. I don't think so. We didn't borrow any money until about 1946, and then he borrowed $750,000 from the Seattle First National Bank.

Q. What contract did you have in 1942?

A. We had the Navy contract, NOY 1035. And it

(Testimony of Lloyd W. Johnson.)

ran about a million dollars, to start with, and it finally ended up more than that. And we had a grain elevator contract for the Port of Seattle in the amount of about $500,000.

Q. Who financed those jobs?

A. Max Kuney. Max Kuney has enough capital so that we do not have to go through the bank. [248]

Q. Mr. Johnson, you testified as to the withdrawals of money as shown on Petitioners' Exhibit 12.

A. Yes, sir.

Q. I call your attention to the sixth item on that exhibit 7, the date being 1-13-44—the date of the 1-13-44 return, $3,600. Do you know what that is?

A. Yes. I withdrew quite a bit of money just before that, and after I paid all the taxes and everything I figured that I drew too much money out of the Western Construction Company, and I didn't want to get the two companies confused. I wanted to keep my capital account and my personal account in the Max Kuney Company exactly what I made in the Max Kuney Company, so I returned $3,600 to the Western Construction Company in my own check. I believe that check was made to the Western Construction Company, but I am not sure.

Q. I notice by that same exhibit, Mr. Johnson, under withdrawals you show and have read into the record the amounts of your withdrawals beginning with 1943. Do those dates on there mean—I am referring to 3-13-43 and 6-15-43—what were those dates—tax payment dates?

A. Yes. I withdrew the money to pay the taxes.

(Testimony of Lloyd W. Johnson.)

Q. Did you use all of it for that purpose?

A. I am not sure. I drew out approximate amounts.

Q. The approximate amounts necessary to pay your taxes? A. Approximately, yes. [249]

Q. Isn't it true that those are the only withdrawals that you did make?

A. I don't know. I made a withdrawal down here for $9,000—January or June 20, 1946. I made a withdrawal of $9,000 to go into busines with Dan Bracken, in a restaurant, and to buy some property.

Q. I will ask you about 1943—44—45, if your withdrawals were not limited to the amounts necessary to pay your federal taxes.

A. Approximately, yes, sir.

Q. You testified that you were paying your estimators with Kuney-Johnson about $150 a week. That is in the year 1948, isn't it?

A. That is 1948, and that is also 1943 and 1944, and 1945.

Q. Do you know what you were paying them in 1942?

A. In 1942 I did most of my own estimating. We were just getting started, and we didn't have enough work to keep an estimator on the payroll.

Q. Are you aware of the fact that there was a salary stabilization act in effect along in those years —1942, 1943 and 1944? A. Sure.

Q. Do you know what you were paying estimators under that act during 1942, 1943 and [250] 1944?

(Testimony of Lloyd W. Johnson.)

A. No, I don't. I know what we paid the estimators, and we were subject to the Wage Stabilization Act, and we were reviewed many times, and the wages that we have paid have been passed by all of the boards and all the investigators, and they have never gone into the business and checked us.

Q. Do you know specifically what you paid them in 1942, 1943 and 1944, or are you testifying generally?

A. I am testifying generally, but I know that we had an estimator by the name of Vic Isaacson that we paid $125 a week.

Q. What was his qualification?

A. He was a college graduate.

Q. A graduate engineer?

A. A graduate engineer. He worked for the Puget Sound Bridge and Dredging Company for a while. His father was a small contractor in Portland. He had some outside experience to qualify him to do this work, too.

Q. Could you entrust large jobs to him?

A. No, I always would check them over myself, of course.

Q. Did you pay some others less than the amount that you paid him?

A. No. I think that that was about the minimum that we paid.

Q. How many estimators did you have?

A. Well, we had one until we went to Bangor. When we [251] went to Bangor, we had about three, I think.

(Testimony of Lloyd W. Johnson.)

Mr. Payne: That is all.

Mr. Potts: Just a minute, Mr. Johnson.

Re-Direct Examination

By Mr. Potts:

Q. Taking the schedule that Counsel has supplied us with, I will ask you if your excess of withdrawals over tax payments would not be approximately $26,-341? Now, of course, you would not know the exact figures, but can you look at Exhibit 12 and give us any help on that. I should say, when I stated your excess of withdrawals over tax payments would be approximately $26,341, $26,000 over and above the amount that you withdrew to pay income taxes.

The Court: That is covering the period from 1942 to 1946, inclusive?

Mr. Potts: 1945 I think—'43 to '45.

The Court: All right.

Q. (By Mr. Potts): Is that correct, Lloyd?

A. I cannot answer that question.

Mr. Potts: May I show the witness your schedule that you have there, Mr. Payne?

Mr. Payne: Yes, indeed. (Handing document to Mr. Potts.)

Q. (By Mr. Potts): Will that assist you, [252] Lloyd?

The Court: Are you going to put on the bookkeeper?

The Witness: I am not a bookkeeper and accountant. Let her testify to that.

Mr. Potts: All right. I will save that for her.

(Testimony of Lloyd W. Johnson.)

Q. (By Mr. Potts): Now, your income taxes were quite heavy, were they not?

A. I thought that they were.

Q. Well, you had two businesses. You had both your interest in the Western Construction Company and in the limited partnership, and you had your interest in Kuney-Johnson, is that right?

A. Yes, sir.

Q. During these years?

A. Yes, sir, that is correct.

Q. So that your situation was a little bit different than most of the other limited partners?

A. That is correct.

Q. With respective taxes? A. Yes, sir.

Q. Directing your attention to Respondent's Exhibit C, the articles of co-partnership which Counsel has shown you, that were signed on the 6th day of January, 1941, and I will read you two paragraphs, as follows, as the foundation for asking you a question, "Whereas, Roy W. Johnson and Lloyd [253] Johnson are the owners of a substantial stock interest in said Western Construction Company, Incorporated, and relinquished their stock interests to their respective fathers upon their promise that they would give an interest in this partnership now being formed; and

"Whereas, as Winston Johnson, the son of Albin Johnson, has now reached his majority and has given up his college career to enter the construction business and work with his father; and

"Whereas it is the desire of the said J. A. John-

(Testimony of Lloyd W. Johnson.)

son, George Johnson and Albin Johnson to have their respective sons, all of whom have been educated and trained in the construction business, to become associated with them in the construction business;

"Now, therefore," and so forth—Counsel has asked you whether this was a part of the agreement or if this was an attempt to form a co-partnership that failed.

Now, what were the facts about the making of this co-partnership. Directing your attention to those paragraphs that I have just read relative to the construction company incorporated, what were the facts about the making of this co-partnership?

A. Well, the facts there were just that we gave up our stock in the Western Construction Company, Incorporated, and were given an interest in the Western Construction Company. [254]

Q. Let me put it this way, Lloyd. Wasn't Exhibit C here an attempt to hold you, among other things—wasn't it an attempt to hold you in the business with your father and your uncles and your cousins, when this Kuney Company was developing?

A. Yes. That was always discussed, why should I go with somebody else when I had an opportunity like this here?

Q. Now, when you went with Mr. Kuney, Counsel has asked you if Mr. Kuney's offices were in Spokane, and your answer was, "Yes." Did you spend any time in Spokane?

A. No. I spent all of my time here. The only

(Testimony of Lloyd W. Johnson.)

time I would go to Spokane would be for an occasional trip—just to bid a job.

Q. And now, Emil Erickson was your uncle who did business under the name and style of the West Coast Construction Company, is that correct?

A. Yes, that is correct.

Q. And when you refer to helping out after his death, you were assisting your aunt in cleaning up the details of that construction business, weren't you? A. Surely.

Q. Were there things to be finished there?

A. Well, there was not very much to be finished, but there were just the ends of closing up the business, that is all. Somebody had to take care of those detailed ends. [255]

Mr. Potts: That is all.

Re-Cross-Examination

By Mr. Payne:

Q. Mr. Johnson, you said in answer to Mr. Potts' question, that you gave up your stock in the corporation. You never did own that stock, did you?

A. I had it in my name.

Q. And that is all? A. Yes, sir.

Q. You said that the articles of partnership, Exhibit C, was an attempt to hold you and the other sons with your fathers. You didn't go along with that plan, did you?

A. As I pointed out to you before I believe that one of the most important things in the education

(Testimony of Lloyd W. Johnson.)

of a young engineer who does some day think that he is going to be a contractor is that he finds out how the other fellow does it. It works this way. The people you are working for may make some money, but how do you know that they are building those buildings right. They may be building them wrong. So I went out and found out from somebody else, and I think the record will show that maybe I got some experience that was all right too. At least I made some money. I did a lot of building.

Q. Let me ask you this, did you go with Mr. Kuney against the wishes of your father?

A. Yes. He always wanted me to stay right with the [256] Western Construction Company.

Q. Now, let me ask you another question. You said that your mother died in 1920? A. Yes.

Q. Is that right? A. That is right.

Q. Did your father ever talk to you about your interest in her estate?

A. Yes, he talked to me about that when I became of age. When I became 21, why he told us—we knew at that time—we were grown up, and we knew that we had an interest there, and he discussed it with us, and we had no reason at that time to pull the money out of the Western Construction Company.

Q. Did he ever discuss with you the value of that interest, back in 1920 when she died? A. No.

Q. Did he ever discuss with you the value of it after the depression years of 1935 and 1936, and so forth?

(Testimony of Lloyd W. Johnson.)

A. No, he never discussed its value at all. We just discussed the fact that there was an interest there, and that we had an interest in the company, and we had an interest in the property, too.

Q. Do you understand that that is still pending in her estate? [257] A. Absolutely.

Q. How much?

A. There is nothing that has been done—there has never been anything done on it, and we have never signed any papers or gone to court, which I realize is what we have to do to wash out a deal like that. But that has never been done.

Mr. Payne: That is all.

Mr. Potts: That is all.

(Witness excused.) [258]

Whereupon,

ROY W. JOHNSON

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Potts:

Q. State your full name.

A. Roy W. Johnson.

Q. And your residence?

A. 1520 Olin Place.

Q. In Seattle, Washington? A. Yes.

Q. How long have you lived in Seattle, Washington?

A. Thirty-eight years; all my life.

(Testimony of Roy W. Johnson.)

Q. And what has your education been, Mr. Johnson?

A. I had my elementary and high school training in Seattle and then I went to the University of Washington and I received a degree in civil engineering in 1932.

Q. Did you specialize or take any other engineering course besides civil engineering at the University?

A. No; except in the curriculum for civil engineering we have a little mechanical and electrical but that goes with it. I majored in structures and hydraulics.

Q. Now, you are the son, are you not, of J. A. Johnson, [259] one of the partners in Western Construction Company, a limited partnership?

A. That is right.

Q. Can you tell the Court when you began to work for Western Construction Company?

A. Yes; near 1923 when I was 13 years old I had my first employment on the Schaeffer building at Sixth and Pine in Seattle.

Q. Since then what have you done, if anything, with the construction business?

A. Each summer and each school vacation, likewise Christmas vacation, I went on the job Western Construction had in process at that time. Besides the Schaeffer building, there was a garage at Third and Blanchard, the Puget Sound Bank, the Oregon City Woolen Mills, Queen Anne Apartments, Marl-

(Testimony of Roy W. Johnson.)

borough House, and there was probably two or three others in the time I was there.

Q. Now, after you graduated from the University of Washington and took your degree in civil engineering, what did you do after that?

A. Well, I finished the University in 1932, right at the peak of the bottom of the depression and employment was rather difficult to secure, but I and one other fellow from our civil engineering class were lucky to get jobs and we received employment in the engineering department of Boeing Aircraft Company. [250]

Q. What department; what kind of work did you do?

A. I was doing engineering, lay-out work, detailing, and stress analysis, from 1932 to 1935. Three and a half years. And after that I went to work for the Army Engineers at Portland, Oregon, on the design of the fishway structures for Bonneville Dam.

Q. How long did you stay there?

A. Six months, temporary appointment, until the spring of 1936. Then I was a year with the Portland General Electric Company, from the spring of 1936 until the spring of 1937, at which time I was designing the trolley overhead system for Portland, Oregon, laying out the curves for intersections for the trolley wires overhead. At the close of that employment, I worked for the Howe Sound Company at Chelan, Washington, designing a concentrator mill at Lake Chelan. I was there the summer of 1937 and then I went to Port Angeles and was employed

(Testimony of Roy W. Johnson.)

by Ray Mear, Incorporated, on a pump mill at Port Angeles, and then designed a steel boiler for a new mill at Fernandina Valley. That took me until the fall, I think it was, of 1938. Then I was with the State Highway Department at Olympia, designing bridges for about six months, and then I went to Portland, Oregon, again, and had a job with the Bonneville Power Administration as assistant engineer, at which time I was designing structures and river crossing towers for the [261] Bonneville Power Administration. I was there until the fall of 1939; I was there thirteen months. And then I came to Seattle and had charge of the design of the trolley overhead system in Seattle at the time that the city rehabilitated the transportation system and took out the old street cars.

Q. In regard to that project, did you do anything other than design it?

A. Oh, I had about over twenty or thirty engineers and draftsmen under me and we laid out the routes and the general design and then took down the detailed design and the curves and intersections to lay out the work.

Q. What about the material?

A. Oh, yes, we ordered all the special work. The curves and the turn sections and hardware and cable and wire and insulators and all the hardware required.

Q. All right; what did you do after you completed that work for the Seattle Transit System?

(Testimony of Roy W. Johnson.)

A. Then I opened an office of my own as a professional engineer.

Q. Will you give us about the time?

A. That must have been in the fall of, I think, 1939, and I started to hang out my own shingle as a professional engineer and one of my chief jobs was to take off quantities for the Quartermaster Corps of the United States Army on hangars and other structures that they were building in Alaska. [262] And then I became associated with the Metcalfs; they were appraising public utilities for the sale of electric power and public water systems and I was with them about six or seven months, and we were working on the sale of public, or electric systems.

Q. Those are what is known as PUD systems?

A. Yes; public utilities districts.

Q. Yes.

A. And then I worked on the appraisal of a public water and electric system in Sitka, Alaska, at the time they formed their own utility arrangement. After that I worked on the design of the Seattle Port of Embarkation pier for the firm of Bevin, Jones and Boulon, and from there I went to the Port of Seattle, and designed the terminal which is now used by the Alaska Steamship and Northland Transportation Company. That is the largest pier in the City. After that I worked at Bellingham as chief engineer and general manager of the Bellingham Iron Works. They were doing war work making parts and casings for small shipyards up and down the coast. At the end of that I was back with

(Testimony of Roy W. Johnson.)

Bevin, Jones and Boulon and we were designing a steam boiler plant for the Army Air Depot at Spokane, and worked on designs for housing projects and sewage disposal facilities. That took us through 1942; so that during that time, from 1932 to 1942, during the depression years and during the beginning of war, I was getting various experience as a designer [263] and structural engineer in these various capacities through the States of Oregon and Washington.

During that time, while I was in Seattle, I was helping Western Construction Company every time they had a bridge job. I was employed to design the false work that supported the bridge during time of construction, to support the form work for the bridge and also helping them take off quantities and do estimating on projects from time to time.

Q. Now, Mr. Johnson, directing your attention to the formation of the limited partnership of Western Construction Company, in 1942, will you tell the Court what you know about the formation of that limited partnership?

A. After the Coulee Project, or construction job, the company was hard hit financially and they formed this corporation of which you have heard previous testimony and I was the vice president of that organization. After the company was again on its feet and had retired its debts, it was decided to change it back into a partnership and I was invited to retain an interest in the company.

Q. At this point may I interrupt you, Mr. John-

(Testimony of Roy W. Johnson.)

son, and show you Exhibit C. Would you look that over and tell the Court what you remember about that instrument?

A. Whereas Lloyd Johnson and Roy Johnson——

Q. You don't need to read it out loud. It is in evidence. Let me ask you some questions about it. Is that your [264] signature, by the way?

A. That is right.

Q. Do you recall this? A. Yes, I do.

Q. What was the purpose of these articles of co-partnership dated the 6th day of January, 1941?

A. The purpose was to establish a partnership of Western Construction Company to carry on the business and to take in Lloyd and Winston and myself into the partnership and get us established so that at a future date we would eventually be the—we would have the full responsibility of the business in our own hands as the older partners retired.

Q. Can you tell us about the age of your father and your uncles? A. That was about——

Q. 1941.

A. 1941, Dad was 62 and George then would be—I think he is two years younger, so that would be about 60; and Albin, six years younger, so he would be about 54.

Q. Can you tell us anything about your father's health at that time?

A. Well, Dad has been fighting a physical handicap all his life. One of his principle troubles has been a leg ailment, I think it is called osteomolitis. It is a bone infection. I think he had operations first

(Testimony of Roy W. Johnson.)

when he was seven years [265] old and I think he has had eight major operations, and then it would go through his system and affect his whole health and his health has not been too good lately, and he has been having trouble, certainly for ten years, and he has slowed up considerably, but he has been a hard worker and it is hard to slow up.

Q. Now, Roy, after these articles were executed, did you continue on then as six general partners, or what happend, do you recall?

A. Well, we carried on in that capacity for a time. Of course, I was doing this other work and I couldn't leave immediately to devote my full time to the business, but the idea was that we would, us three new or younger partners, would render such service as engineers, superintendents, foremen and estimators as we were able to do and as circumstances permitted but, as Lloyd Johnson has testified, it has been our intention and in the back of our minds, that eventually we would become owners or the partners in Western Construction Company. That has been my interest all my life, and my personal desire was that I wanted to work with Dad and be a partner with him and carry on business together, because construction business, and engineering, and the building of structures has been my goal and my aim and my life, and it is something I wanted to do and I was looking forward to the time when I could devote full time with Dad in the business. [266]

Q. Back in 1941, review for me again, what were

(Testimony of Roy W. Johnson.)

you doing? With whom were you employed at that time?

A. In 1941 I was chief engineer and general manager of the Bellingham Iron Works.

Q. And can you tell us approximately what salary you were getting at that time?

A. I was getting then about five hundred dollars a month.

Q. And were you married at that time?

A. Yes.

Q. Did you own your own home?

A. Yes.

Q. Where was that home?

A. My home was on Capital Hill, 1520 Olin Place, just on the east side of Lake View Cemetery.

Q. That is the same address you have given; you are still living in the same place?

A. Yes; I purchased that home in 1940.

Q. All right. Now, what was the financial condition of Western Construction Company at that time in 1941; can you tell us?

A. Well, they were just getting out of the slump and getting some debts retired that they incurred, especially on the Coulee Project.

Q. Now, you have heard Lloyd Johnson testify about his relations with Kuney? [267]

A. Yes.

Q. Do you know whether that had anything to do with the formation of this partnership; the articles of which we have just shown you?

A. It was a desire of all of us to work together

(Testimony of Roy W. Johnson.)

and if we could have the basis for an association, it would be showing that the intent was to get us together and as circumstances would permit, we would have one goal to work toward.

Q. At that time you and Lloyd were both rather mature and had good connections and positions, didn't you?

A. That is right. I was born in 1910 so that I was 31 years old and beginning to get dry behind the ears.

Q. Now, can you tell the court whether you did work under those articles of copartnership that have just been shown you?

A. Yes, business had been carried on for sometime under that arrangement and I was not able to give full time but a little time and service from time to time on false work, estimating and design if I was in Seattle and able to give further time.

Q. I ask you whether or not about that time the Western Construction Company wasn't tied up with Emil Erickson or West Coast Construction Company in a joint venture?

A. It was at the time they had this joint venture with the West Coast at Bremerton. [268]

Q. Yes, and it was sometime before that project was out of the way, wasn't it?

A. Yes; it was. That carried through 1942, I think, if I remember right.

Q. Through 1942 or into? A. Into 1942.

Q. Now, with respect to the limited partnership, which is before the court here, will you tell the court

(Testimony of Roy W. Johnson.)

how that came to be organized and how you obtained your interest?

A. This partnership arrangement of the three fathers and the three sons carried on by them, it was felt that here we have each of the fathers having a family of one son and several daughters each and it appeared like an arrangement in which the sons were going to inherit the business and take over without a fair allotment towards the sisters and their husbands and Rachel was married to Len, who was also a graduate engineer, and my sister Evelyn had a husband who was a pressman who you have spoken about but he is full of life and energy and we said that if we bring in the sisters we want them to share in the inheritance or in the business as it were, wanting their husbands to receive a part of the business and if circumstances permitted let them come into the business and that with that stronger backing and the greater resources we could build a larger company and carry forward to larger projects. I have always been interested in hydro-electric [269] work and dam construction and I felt that if we younger fellows took ahold we could spread out and take larger projects and larger jobs and do work that we enjoyed to do and also possibly substantially increase the earning power.

Q. Now, let me ask you this, how could you get your interest in the partnership, the limited partnership?

A. I subscribed a contribution to the capital of Western Construction in the amount of $6,666.66.

(Testimony of Roy W. Johnson.)

Q. Where did you get the money; the $6,666.66.

A. I borrowed that from dad, J. A. Johnson.

Q. How did you borrow?

A. As I recall it, dad gave me a check in that amount and for the check I gave dad a note.

Q. And what did you do with the money?

A. I turned it into Western Construction Company.

Q. Now, at that time, what were your financial responsibilities, say with respect to paying that note, the $6,666.66.

A. Well, I had good employment and good back ground and training and had the jobs and was making fairly good money and I enjoyed and continued to enjoy good health and figured that I was a good risk and I owned a fine home and car and had a few thousand dollars in the bank.

Q. Now, did you own your home outright at that time? A. No. [270]

Q. How much did you owe on it?

Mr. Payne: I object to that.

A. Six thousand.

Q. What was the value of the home?

A. The home at the time, I paid 11 thousand for it. Now I guess it is worth twice that or more.

Q. But you had a five thousand dollar equity in the home? A. Yes.

Q. Now, your interest was never changed, was it?

A. No.

Q. You had a sister who was not a member of the limited partnership?

(Testimony of Roy W. Johnson.)

A. Yes; she was a younger sister and not of age at that time.

Q. Now, let me ask you this, after the limited partnership was entered into, you gave your check. What did you do then about your carrying on the construction business?

A. Well, the same as we did before. It was our intention to keep on going, but I was unable to devote full time until January, 1943, and at that time Western Construction Company had signed a contract for the construction of a housing project at Renton, Washington, and it was convenient then to leave my work with Veni Bevin, Jones and Boulon and go to Renton. [271]

Q. Did you then give your full time to Western or not? A. Yes, I did.

Q. And can you fix the date, approximately?

A. Right after New Years, 1943, the first week.

Q. What did you do with Western?

A. The first thing I did was to lay out the roads and utilities and buildings out at this project site at Renton. I did the surveying and staking out of the construction and after that work was completed I assisted the general superintendent on the project in dispatching the construction and acting as sort of an assistant superintendent as much as engineer.

Q. Who was the general superintendent on that job? A. Axel Hallberg.

Q. He was an employee, was he? A. Yes.

Q. Now, just go on and tell the court what other work you did and continue right on, if you will, as

(Testimony of Roy W. Johnson.)

long as you were with Western and tell the court what you did.

A. We were at the Renton Housing Project. It wasn't completed until late in the summer or fall, but I assisted Axel Hallberg and dad in ordering materials and seeing that the men had their materials distributed and helping to supervise the work. I also did all the engineering and designing of roads that came about as changes in the construction. There was a [272] little bridge that they put in and I designed the abutments and false work so that we could go in and put this bridge in and at the same time keep the traffic going and was kind of an assistant superintendent and engineer on the project. Then I was in the office while the company was bidding on additional work and they were bidding on the Alaska Transport Stock Shed. I helped take off quantities and estimate that job and we were low bidder and then I went down to help the superintendent at that project, whose name was Gus Nelson, and I again laid out the ground and staked out the excavation so that the diesels and shovels could keep ahead, and laid out the false work so that our carpenters could put in the foundations and follow right through with the docks until that job was on it way and then I came back into the office and was estimating projects, like the Boeing buildings and the cafeteria and food service building. We turned in estimates and bids on other jobs too. At the same time the terminal project came up and it was the same project that I had worked on the

(Testimony of Roy W. Johnson.)

design of with the Port of Seattle and they were advertising for bids for the construction of the two pier sheds; they are a little over 120 feet wide and 1 thousand feet long and it was quite familiar to me having been in the designing and I helped prepare the bids and we were low on that and so I helped my uncle George and Gus Nelson get that work done. Among the peculiarities of that construction was a large hollow dome of 120 foot [273] span and I designed that and helped lay out details for construction. Since we got that job and the Boeing Cafeteria at the same time, I worked on both of them as an interested partner of Western Construction.

Q. Let me ask you this, what salary were you getting during this period which you have just recited from Western?

A. At that time I was being paid on an hourly basis, the basic was $2.05 an hour, as I recall it.

Q. How did that measure up to wages that other companies in this community were paying for the same kind of service?

Mr. Payne: If you know the salaries other companies were paying?

A. Yes. In this instance I know. When we first started I was getting less than that and then the architects and technicians—there is a local union in town for technicians and architects and engineers—and they were paying transit men $2.05 an hour and I know dad said doing that is not substantial work and costs are increasing and I think it fair

(Testimony of Roy W. Johnson.)

that he get at least what they are paying transit men; although I knew that in the meantime I had an interest in the company and was sharing in the profits, yet I had to live at the same time and so I was getting just the minimum of what other men of the same classifications were getting, although I was doing, because of my interest in the company, many other [274] things and taking more responsibility than an ordinary engineer would.

Q. All right; what other work did you do, right on up to the last work for the company?

A. Well, it was decided between the general partners and ourselves that it would be best if I went down and helped Axel Hallberg on the Boeing buildings and I did the same work again, lay out for construction, foundations and excavation and footings and columns and arches, because the terminal job was getting well along. And then it was decided that I better act as the superintendent on the smaller ones, two buildings, while Axel Hallberg looked after the cafeteria.

Q. You mentioned superintendents; how many superintendents did Western have at that time?

A. There were three or four.

Q. Can you name them?

A. Yes; Axel Hallberg, Gus Nelson, and there was a man named Johnson. I forget his first name, but he was looking after the street work, community shopping center, up in Renton Heights and then there was Mr. McKee and he was looking after one

(Testimony of Roy W. Johnson.)

of the other jobs. Perhaps one of the smaller ones. But I remember distinctly there was four.

Q. Now you go right ahead; I didn't want to interupt you.

A. So that on each of the jobs they have got to have a [275] general superintendent, and I became the superintendent on the construction of the food service building at the Boeing plant Number 2, and I carried that through to completion. Then I went back into the office and was busy estimating on other projects. One was an ammunition testing depot, I think they called it, for the Navy, and there were several jobs in process at that time.

But, like I mentioned previously, I had an interest in hydroelectric work and being a designer and engineer also, I wanted to see the company branch out eventually into that type of work and I had a friend at Ketchikan, Alaska, who was superintendent of the Ketchikan Public Utilities and he knew of my experience in hydroelectric work and civil engineering and general construction and he wanted me to come up and be their engineer on the new hydroelectric facilities and about this time this offer came, I felt it would be a good thing to undertake that work.

Q. Now, can you give us the date?

A. That was in June, 1944.

Q. June, 1944? A. Yes.

Q. Now, do I understand then that from January, the 1st of January, 1933, to June, 1944, you

(Testimony of Roy W. Johnson.)

had been with Western all the time doing the work you have just related? A. That is right. [276]

Q. Now, what happened then after June, 1944, with respect to your work?

A. I asked for leave of absence from the general partnership and told them what I had in mind and felt that if I left full time interest in Western Construction for a little while to do this engineering, it wouldn't do Western Construction Company any harm but would broaden the scope of our background and it would be a good job to take so that I left at that time expecting just to do the engineering on that. I took this work as a private engineer under my own name, Roy W. Johnson, and I did work in Western Construction Company's office so that we were all tied together. I was up north for about seven weeks from the middle of June to the 1st of August of that year and ran surveys. I surveyed the power house site, pipe line, and tunnel locations, and the transmission line, and then I hired some engineer and planned the plans and specifications. During January bids were opened for the construction of this project and we estimated the cost around one-half million dollars and bids were received from about three companies but they exceeded the funds available and the estimates so much that the City of Ketchikan decided they would have to reject the bids.

Q. Just a minute. May I ask whether or not Western Construction Company was one of the bidders?

(Testimony of Roy W. Johnson.)

A. No. I wanted them to bid but they decided it would [277] be better if they did not because they had considerable work down here and were finishing up the terminal and other jobs and they were not too much interested in going that far out of town when there was plenty in Seattle and then, also, there was heavy construction involving tunneling and dams and hydroelectrics and they had had experience in that type of work at Grand Coulee Dam and they decided they wouldn't bid at that time and so we got bids from three other companies. I think Morriss and Knutson submitted a bid, and Mr. Summers of Juneau, and one other party and they all exceeded the funds available and the estimates and we tried to negotiate with the low bidder and he didn't want to consider a lower price and as engineer for the City of Ketchikan, I wanted to see the thing built, and the engineer said, maybe we can get it built by letting it out in small contracts and we got proposals from the contractors, from smaller people, who were interested in putting in the tunnel only, or just the transmission line, and felt if we could get these small units organized, we would be able to do it. I could be the engineer and kind of coordinate the activities and by letting out five or six small contracts instead of one big contract, we would get the project done anyway and the city officials encouraged me to proceed by that manner but I ran into difficulty because the job was about twelve miles out of Ketchikan by water and there was no road and somebody had to

(Testimony of Roy W. Johnson.)

provide the transportation and we had to [278] have a construction camp and nobody was willing to do that. Then I began to see that as an engineer I was getting myself an awful lot of work by acting more or less as a general contractor so then I said, well, if I am going to get this job done and act as general contractor in this capacity, I might as well be actual contractor so then we discussed the transportation and the camp and they said, why don't you do the job, and I said, well, maybe I can. If you will allow me, I will go back to Seattle and see if I can't raise the bond and maybe take the contract and I came down to Seattle and dad and I went over the figures and we decided that five hundred thousand dollars was a good bid for doing all the work and I went up and tendered the proposal and the City gave me the general construction contract and that is how I got in the construction business and that job was completed last fall.

Q. Yes. This last fall? A. Yes.

Mr. Potts: Would you mark this, please?

The Court: Petitiner's Exhibit 15, for identification.

(The document referred to was marked Petitioner's Exhibit 15 for identification.

Q. (By Mr. Potts): Showing you Exhibit 15, marked for identification—— A. Yes. [279]

Q. Would you examine that, please, and tell the court what that is?

A. This is the statement of my interest in Wes-

(Testimony of Roy W. Johnson.)

tern Construction Company. It shows the initial investment of $6,666.66, plus the accumulated interest I received through the earnings of 1943 on; 1943, 1944, and 1945.

Q. And do they total—— A. $60,433.97.

Q. Now, would you go on and explain the exhibit?

A. Then the next paragraph, in the withdrawals of my interest from Western Construction Company. They started in March 13, 1943, at which time I took out $2,050 for taxes and $950 as a cash withdrawal. Then June 15, 1943, 2,050 dollars for income tax; September 13, 1943, $2,050; and December 28, 1943, $2,050. Then again on April 10, 1944, six hundred dollars; May 15, 1944, $380.92; and May 15, 1944, it was $381, and also on the same date, $532.13. Also on May 15, 1944, $532. Then on June 13, 1944, withdrawal of $600 and on September 13, 1944, $600. On January 10, 1945, withdrawal of $1,000; on March 1, 1945, a cash withdrawal of $20,000. On March 13, 1945, withdrawal of $455.61; on March 13, 1945, $457.48; on June 26, 1945, cash withdrawal of ten thousand dollars and on July 30, 1945, a withdrawal of nine thousand dollars, making a total of withdrawals of $52,785.27.

Q. Now, take the next. [280]

A. Then on May 31, 1946, I returned to Western Construction Company, for an overdraft, the amount of $6,600.00.

Q. Will you explain that to the court?

A. I had taken these withdrawals just previ-

(Testimony of Roy W. Johnson.)

ously mentioned at a rate that was higher than I was entitled to and I had overdrawn in the amount of something like six or seven thousand and I was up at Ketchikan and I received a note from Mrs. Potts and she said you have overdrawn and you better send me back the money so that I sent a check for 66 hundred dollars.

Q. And that was while you were doing this contracting?

A. Yes. I withdrew it for my working capital at Ketchikan.

Q. All right.

A. On December 31, 1946, I was credited with $2822 for a share in net profit. Then on January 14, 1946, I took out $126.52 and there was a bank charge of $16.50. I think that was for transfer charges from Seattle to Ketchikan. On February 2, 1947, I withdrew three thousand dollars in cash and again, February 17, 1947, I withdrew $2,500, making a total of $58,428.29.

Mr. Potts: We offer, if the court, please, Petitioner's Exhibit 15. A little later when we place the bookkeeper on the stand there is one check that covers some of these items and that will be explained. [281]

Mr. Payne: No objection.

The Court: Very well. It will be received as Petitioner's Exhibit Number 15.

Q. (By Mr. Potts): Now, after you got through with your project up at Ketchikan, what did you do after that?

(Testimony of Roy W. Johnson.)

A. Well, I have been doing other work along with this project. For instance, at Sitka, I was employed as engineer there and I designed a hydro-electric installation for the City of Sitka.

(The document heretofore marked Petitioner's Exhibit 15 was admitted in evidence as Petitioner's Exhibit 15.)

PETITIONER'S EXHIBIT No. 15

Roy W. Johnson

Jan. 1, 1942, to Dec. 31, 1945.

5/28/1942	Cash investment		$ 6,666.66
12/31/1942	Share of profits, 1942		23,743.94
12/31/1942	Share of profits, 6 mos. 1943		11,946.54
12/31/1942	Share of profits, 6 mos. 1943		7,718.17
12/31/1942	Share of profits, 1944		2,767.00
12/31/1942	Share of profits, 1945		7,591.66
			$60,433.97
Withdrawals			
3/13/1943	Income tax	$2,050.00	
	Cash	950.00	$ 3,000.00
6/15/1943	Income tax		2,050.00
9/13/1943	Income tax		2,050.00
12/28/1943	Income tax		2,050.00
4/10/1944	Collector of Internal Revenue		600.00
5/15/1944	Collector of Internal Revenue		380.92
5/15/1944	Collector of Internal Revenue		3.81
5/15/1944	Collector of Internal Revenue		532.13
5/15/1944	Collector of Internal Revenue		5.32
6/13/1944	Collector of Internal Revenue		600.00
9/13/1944	Collector of Internal Revenue		600.00
1/10/1945	Cash withdrawal		1,000.00
3/ 1/1945	Cash withdrawal		20,000.00
3/13/1945	Collector of Internal Revenue		455.61
3/13/1945	Collector of Internal Revenue		457.48
6/26/1945	Cash withdrawal		10,000.00
7/30/1945	Cash withdrawal		9,000.00
			$52,785.27

(Testimony of Roy W. Johnson.)

Investment amount brought forward		$60,433.97
5/31/1946	Return of overdraft	6,600.00
12/31/1946	Share of net profit	28.22
		$67,062.19

Withdrawals brought forward		$52,785.27
1/14/1946		126.52
6/29/1946	Bank charge	16.50
2/ 2/1947	Cash withdrawal	3,000.00
2/19/1947	Cash withdrawal	2,500.00
		$58,428.29

Admitted May 25, 1948.

Q. (By Mr. Potts): Where is your office now?

A. 605 Arctic Building. I use the same space Western Construction Company does.

Q. Is Western Construction Company active at the present time? A. No.

Q. Who is taking care of their business there?

A. Oh, I am helping to take care of the business as mail comes in that is important. I look it over and if it is something I can take care of, I do; and if it is something the general partners need, I give it to them, and I [282] have a girl there and as Western Construction Business comes in and it is a matter for the general partners to take care of, I see that they get it, but the general partners are not down very much any more.

Q. Was there any meeting of the limited partners as such ever held? A. No.

Q. Did you receive any certificate or any instrument that showed your interest in the partnership other than the articles of copartnership?

(Testimony of Roy W. Johnson.)

A. That is all; just the articles.

Q. Was there a president or a secretary or any officer elected with respect to the limited partners?

A. No; there was none at all.

Q. Did you ever give a proxy to any one for your interest to vote it? A. No, sir.

The Court: Did the partnership have a seal?

The Witness: I never saw one.

Mr. Potts: Your witness.

The Court: We might as well take a ten minute recess before we begin the cross-examination.

(Whereupon, a recess was had from 10:50 o'clock, a.m., until 11:00 o'clock, a.m., May 25, 1948.)

The Court: All right; you may proceed. [283]

Mr. Potts: May I have your indulgence; I would like to ask another question.

Q. (By Mr. Potts): You have given us the names of some superintendents that the partnership had. What was your relation as respects the work with these superintendents?

A. Well, I was one of the partners of Western Construction so they were my subordinates. I was superior to the superintendents but I was doing work on these jobs that they could not do. I was trained technically to design and engineer that none of these superintendents were qualified to perform.

Q. Were any of these superintendents civil or structural engineers? A. No.

Mr. Potts: Your witness.

(Testimony of Roy W. Johnson.)

Cross-Examination

By Mr. Payne:

Q. In connection with the testimony you just gave, Mr. Johnson, I show you a document, Petitioner's Exhibit 1, and call your attention to paragraph 10 of that document and ask you what the purport of that paragraph is?

The Court: Do you want him to read the paragraph?

A. The entire management of the partnership shall be vested in the three general partners and the right is hereby [284] given to the remaining partners to continue the business upon the death or retirement of a general partner, and the right is also given to the general partners to continue the business upon death or retirement of any of the limited partners hereto.

Q. Is that your understanding of the limited partners, that the management and direction was given to the limited partners?

The Court: To the general partners, you mean.

Q. I mean limited partners. I am sorry, general partners. A. That is right.

Q. And I show you Exhibit Number 3, in evidence, which is the second limited partnership and call your attention to paragraph 10 of that agreement and ask you if that is the same as the one you have just read? A. Well,——

Q. The one you just read from, Mr. Johnson, is the agreement executed February 24, 1942; Exhibit

(Testimony of Roy W. Johnson.)

Number 3, which I now show you, is the second one executed——

A. June 30, 1943. Oh, yes, the difference——

Q. I just ask you about the paragraph 10, regarding the management. That is the same?

A. Yes; that is right.

Q. So when you state that as a partner you had a right to direct the affairs of the partnership, that is your own [285] conclusion, isn't it?

A. You mean in the question that Mr. Potts just gave me?

Q. Yes.

A. It probably is my own conclusion in one sense, but we are working together and I have been on many jobs and was trying to work like a team and we don't try to put one up above the other such that he is the boss. It is a mutal understanding. We talk these things over and we understand but in the sense I was one of the partners of Western Construction, I had authority over the general superintendent but we worked together and I did the work that they couldn't perform, the technical work.

Q. What do you mean by that?

A. The technical work; the laying out, designing, false work, surveying, and stress analysis and figuring out sizes of beams, the false work, that they were not able to do.

Q. Who was the general superintendent?

A. The general superintendent on the Renton Project was Axel Hallberg.

Q. That is just on one project?

(Testimony of Roy W. Johnson.)

A. Yes; in other words, the way it is set up as these projects came along, first my dad would take a job and then next one, George, and then Alvin. Then more jobs would come along so there were times when each of the general partners are looking after two or three different construction jobs [286] and then on each of the construction jobs they would place a superintendent who would work under the general partner to give directions to the foreman to see that we had materials on time ahead of the workmen. So far as where the general partners were, they went from place to place. They were continually on the job and then in the construction of these jobs, the survey and staking out, had to be performed, and elevations established, and the false work had to be designed to support the concrete forms and floors and there was design changes coming up which a contractor has to perform and that was work that I was doing and then at the same time Axel Hallberg and Gus Nelson worked together and we would agree, and say, Roy, you can go down and take care of that gang and see that this is started and I would go and do that and Nelson, in pouring concrete, would be doing another phase and all the time there was an exchange of assistance.

Q. Is it true that each of the three general partners took certain responsibility for certain jobs taken by the partnership?

A. That is right; instead of having too many cooks in one broth, they divided the jobs up so that

(Testimony of Roy W. Johnson.)

there would be centralized authority on each job and that way there was no duplication of effort and then when difficult problems came up that required the advice and assistance of the others, they would discuss it generally and mutually agree what should [287] be done but on the particular job in question, that general partner would execute the performance of that decision.

Q. You said that you had superintendance of one job, the service building at Boeing?

A. Yes.

Q. How large a job was that?

A. Oh, that job was in the neighborhood of 200 thousand dollars.

Q. Was that one of your father's jobs?

A. Yes.

Q. You worked there under the direction of your father? A. Yes.

Q. Mr. Johnson, you testified about three or four other superintendents on the Western Construction jobs? A. Yes.

Q. Do you know what scale of pay they were given?

A. Oh, I am not sure because I didn't sign the pay rolls but it was somewhere around 125 dollars a week; in that neighborhood.

Q. Did they pay them on a weekly basis? Or hourly basis?

A. On an hourly basis, no. On a weekly basis.

Q. You said you were paid on an hourly basis with Western?

(Testimony of Roy W. Johnson.)

A. For a time during 1943 and 1944; yes.

Q. And then you said you complained to your father that [288] you weren't getting enough and asked him to put you on an hourly basis?

A. I had some obligations to meet and I needed a little more cash that I didn't withdraw from the company at that time so I felt in line with the work that I was performing that I was justified in getting more cash at the time.

Q. And then did they pay you the $2.05 an hour?

A. Yes.

Q. And I suppose you got some over time in on those too, didn't you?

A. I think I turned in a few hours over time; but I was working overtime every day.

Q. Double time for over time?

A. No, at most time and a half.

Q. Were you a member of the Union?

A. No.

Q. The other superintendents were not members of the union either?

A. I don't know. I think some of them were members of the carpenters union, but I have never joined any union.

Q. What was the scale of the pay of a first class carpenter at that time?

A. As I recall, it was about $1.70 an hour, or $1.75.

Q. Now, Mr. Johnson, coming back to the first part of your testimony, you testified that you were

(Testimony of Roy W. Johnson.)

vice president of [289] Western Construction Company, Incorporated? A. That is right.

Q. Who was president?

A. Lloyd Johnson.

Q. How long did you continue as such officers?

A. During the full existence of that corporation. I don't remember now how long it was. About four years, I think.

Q. How did you obtain those jobs; did your fathers ask you to take those jobs? A. Yes.

Q. Why?

A. In order that they would be able to continue in business during the time that they were hard pressed financially.

Q. You didn't put any money in the corporation at that time? A. No.

Q. Or later? A. No.

Q. The stock belonged to your father, the stock assigned to you belonged to your father?

A. The stock was in my name so I assumed that it belonged to me.

Q. You did?

A. Yes; it was in my name. It was an understanding so [290] that they could carry on their business.

The Court: You mean that you were the legal owner and the beneficial owner was your father?

The Witness: Yes; I was the legal owner.

The Court: And it really belonged to your father?

The Witness: That is right.

(Testimony of Roy W. Johnson.)

Q. (By Mr. Payne): And you would say the same was true of the stock owned by Lloyd?

A. That is right.

Q. And who were the other officers; Mrs. Potts?

A. Yes.

Q. Did she have some of the stock in her name?

A. I presume she did.

Q. You don't know?

A. I never looked at it.

Q. I call your attention, Mr. Johnson, to Respondent's Exhibit A, in evidence, and to the resolutions attached there, with respect to the dissolution of the corporation, showing J. A. Johnson as president and George Johnson as secretary; can you explain that?

A. No. Not off hand. I don't remember; I don't know just what this is.

Q. I told you it purported to be the certificate of resolution dissolving Western Company in 1942. [291]

A. This looks like dissolution of Western Construction Company, Incorporated, in which J. A. Johnson, George Johnson, and Alvin Johnson are the officers. But apparently during that time in which I was employed on these various jobs they probably changed officers.

Q. You don't remember about that?

A. No; I wouldn't.

Q. You didn't devote your full time to the Western Construction Company, partnership, in 1942, did you? A. No.

(Testimony of Roy W. Johnson.)

Q. You were working elsewhere at that time?

A. Yes.

Q. How much of your time did you devote to Western that year?

A. Oh, part of that time I was out of town and busy so that I don't suppose it was over five per cent.

Q. In 1942? A. Yes.

Q. How much would you say you devoted to the business in 1943? A. 100 per cent.

Q. And in 1944?

A. 100 per cent until I went to Alaska in June.

Q. Of 1944?

A. Yes; the latter part of June. [292]

Q. And after that you devoted no service to Western?

A. Well, through the fall of 1944 and the first part of 1945, it was during the time I was engineering this hydroelectric company and we had joint offices; I was performing my work in Western Construction's offices so that I was more or less aware of what was taking place and was in and out and as has been our custom we discussed the various projects; estimating and prices and so I undoubtedly contributed services during that short time also.

Q. You gave some testimony about Respondent's Exhibit C. You never did actually operate under that partnership, did you, Mr. Johnson?

A. This is the first partnership after dissolution, isn't it? No.

(Testimony of Roy W. Johnson.)

The Court: No; that is before dissolution of the corporation.

Q. (By Mr. Payne): The record shows the corporation was dissolved in 1942, Mr. Johnson, and this is a partnership purportedly entered into in January, 1941.

A. Oh, I see. No, this one never operated.

Q. What was that?

A. This one never operated.

Q. Why?

A. The purpose of that was to get Lloyd back into the [293] company and to increase our joint strength by being banded together under a partnership agreement and we failed to get Lloyd back in at that time.

Q. You heard Lloyd's testimony this morning, didn't you? A. Yes.

Q. That he left and went with Max Kuney over in Spokane against his father's wishes?

A. Yes.

Q. And is that one of the reasons it was determined to form another partnership in 1942?

A. That was one of the reasons; yes.

Q. You testified another reason was that you wanted to bring the girls into the business; is that right? That your father and uncles wanted to bring the girls in?

A. The girls, but particularly the sons-in-law, the girls' husbands.

Q. I see. You testified that you had a younger

(Testimony of Roy W. Johnson.)

sister that did not become a member of the limited partnership? A. That is right.

Q. Do you know why she was left out?

A. She was not of age.

Q. Was it disclosed whether the younger one should or should not be brought in?

A. I am sure that that was discussed because she was [294] also a member of the family and we have a lot of regard for her, but as I recall, the decision was that we wouldn't bring her in until a future date when she became of age.

Q. I see. You testified that when you went to Alaska to work on that job in 1944, you felt like your services would not be seriously missed; is that what you said? A. No.

Q. What did you say?

A. I felt that in the over all long range picture that by my undertaking that work that the benefit derived from that experience would benefit Western Construction Company to a greater extent than if I just stayed and continued full time service with Western Construction Company. In other words, I have always had an interest in hydroelectric work and I have a desire or had a desire that Western Construction Company would get into that type of heavy civil engineering construction and that if I could get the benefit of this experience of designing this hydroelectric project it would be one step toward the ultimate participation of Western Construction Company in that type of construction and work.

(Testimony of Roy W. Johnson.)

Q. Did you discuss with your father the matter of going up there? A. Surely.

Q. Did he want you to go? A. No. [295]

Q. You went anyway? A. I went anyway.

Q. You gave testimony, Mr. Johnson, about Petitioner's Exhibit 15, which I place before you?

A. Yes.

Q. I believe you said that your stated investment in the partnership came from your father and you put it back in at his request?

A. That is right.

Q. Did you give him a note for that amount?

A. Yes.

Q. You testified about the withdrawals?

A. Yes.

Q. I believe on the second page of this exhibit you testified about the large withdrawal in 1945? A. Yes.

Q. Twenty, ten and nine thousand and other smaller amounts? A. Yes.

Q. Something in the neighborhood of forty thousand dollars in one year; is that right?

A. Yes.

Q. How did you go about withdrawing that money; did you talk to your father about it?

A. Yes. [296]

Q. What did he say?

A. He said it is your own money and you have to have it. I told him I needed the money for working capital to perform this construction up there and I had a legitimate and a right use for it

(Testimony of Roy W. Johnson.)

so he said you may use it. It is yours and if you can do more with it in this venture of your own and it will earn more for you that way, then as a part of the receipts from Western Construction, that is up to you. I was interested in using that money where it would earn the most.

Q. Your stated investment was $6,666.66?

A. That is right.

Q. And your stated share of the profits was?

A. Share of the profits?

Q. For 1942? A. $23,743.94.

Q. In addition to that you received your compensation for the services you rendered under the arrangements you testified about?

A. Not in 1942; we didn't receive any salary.

Q. That is right. I should correct that. That amount you received without any service.

A. Without any compensated service.

Q. And then when you went to Alaska you still got your proportionate percentage, based on your stated capital investment? [297]

A. That is right.

Q. I ask you, Mr. Johnson, about the withdrawals in 1943 and 1944, and can you tell from examining this exhibit 11, exhibit 15, the purpose for those withdrawals?

A. Well, these were to pay the income tax.

Q. All of it? A. Well, most.

Q. Substantially all of it?

A. Substantially all of it. Here in 1943 I took

(Testimony of Roy W. Johnson.)

out 3000 dollars of which $2050 was for paying income tax and $950——

Q. What did you use that for, do you remember?

A. I put it in my bank account for running expenses.

Q. All the rest, in 1943 and 1944, were used for federal income taxes?

A. These were all income taxes, yes. Then January 10, 1045, a cash withdrawal that I put in my own funds. I needed that for working capital in my engineering business. Then in March, 1945, I needed the 20 thousand as working capital in my construction work and then here is income tax payments and these are other withdrawals in my construction work.

Q. I want to ask you one other question. You said you took that last job for about five hundred thousand dollars and completed it in 1945? [298]

A. No; it started in 1945. We had hoped to get it completed by December, 1945, but we did not get it completed until the summer of 1947.

Q. Did you make a profit on that contract?

A. No.

Q. A heavy loss?

A. No. Not too bad a loss, but just about even if I don't pay any salary to myself during that time, but that just shows what the construction business is like. One job you probably make good and then the next one you can go for a ride and this was my first one and I ran into some circumstances that

(Testimony of Roy W. Johnson.)

were not anticipated and we worked mighty hard and didn't make any money so that is one of the contingencies of this type of work.

Mr. Payne: That is all.

Mr. Potts: That is all, Mr. Johnson. Thank you.

(Witness excused.)

Mr. Potts: Mr. Winston Johnson, please.

Whereupon,

WINSTON ALBIN JOHNSON

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows: [299]

Direct Examination

By Mr. Potts:

Q. Will you state your full name?

A. Winston Albin Johnson.

Q. Where do you live, Mr. Johnson?

A. 5536 Coniston.

Q. Is that in Seattle? A. Yes, it is.

Q. How long have you lived in Seattle?

A. All my life.

Q. And how long might that be?

A. I am 29 years old.

Q. What is that? A. I am 29 years old.

Q. Now, Winston, you are the son, are you not, of Alvin Johnson? A. Yes.

Q. What has your education been?

(Testimony of Winston Albin Johnson.)

A. I have had three years of college in engineering.

Q. And you specialized in what?

A. Civil engineering.

Q. You did not graduate?

A. No; I didn't.

Q. Was there any reason for that?

A. Yes. When I left school that last summer to work [300] for my father there was a contemplation of war and there was compulsory military training and I belonged to the National Guard and they were trying to get me in and I was on a temporary basis so that I didn't go back to school and then December 7th, Pearl Harbor Day, I decided to wait to see what would happen because they were going to call me.

Q. Did you go into the service?

A. Yes; I did.

Q. What branch?

A. I was in the army engineers.

Q. And how long were you in the service?

A. I was in the service for two months, but I spent that time flat on my back. I had an allergy ailment that didn't allow me active service.

Q. Were you separated from the service?

A. Yes; I received an honorable discharge and I explained what I was doing at home and my ailment was such that if I was in civilian life my ailment didn't bother me and when the court decided that I was to go home, they suggested that I was better off in that capacity at home than to the army engineers.

(Testimony of Winston Albin Johnson.)

Q. When were you separated?

A. In 1942, about in March of 1942.

Q. Now, when you were separated from the service and came home, what did you do? [301]

A. I went to work directly for the Western Construction.

Q. Referring to the limited partnership formed in that year, will you please tell the court the reason for the entering into the limited partnership?

A. Shall I start at the beginning? I have always had the anticipation to work in the construction business.

Q. I am sorry. I just took your education. Will you tell the court whether you had any practical experience in the construction field?

A. Yes, I had. We started very young. I worked with my father before when I was about twelve or thirteen years of age. I did everything from passing water up the line. I did carpenter work and I did labor work and as I got older and more responsible I took more responsible positions and up until the time before I went into the army, I was working for Western Construction at that time in the foreman capacity and on the jobs working and when I finally got out of the army, I went into the office for Western Construction Company. [302]

Q. Now, if you will go back, I wish you would go back to the other question and tell the Court the reason why you entered into this limited partnership.

(Testimony of Winston Albin Johnson.)

A. Well, the purpose of this limited partnership was to secure credit, as has already been stated, and also to hold the three boys and their sisters and their respective spouses to make this organization—for a larger capital, and to have a larger capacity for operating on larger work.

Q. Now, what was your particular interest in it?

A. Well, I had a very bright future in it. The thing I wanted to do—I have always dreamed of the Western Construction Company being probably one of the largest construction companies in the Northwest, and we have always done large work, and we have gotten a good name for ourselves, and I could not see why we could not continue this, the three boys with the help from their sisters and the husbands of their sisters, and even though those husbands, like Mr. Ellingson, worked for us as a foreman, even in that capacity the fact that he was in the family and had an interest in the company, would be better for him and better for the company than other men that just were working for wages and had no other interest. And I still foresee in the future that the three boys and myself and the rest of us are going to continue in this type of work, and I still have got ambitions about this company becoming something again. [303]

Q. How did you get your interest in the limited partnership beginning, first, with the one in 1942?

A. I borrowed the money from my father.

Q. How much did you borrow?

A. $10,000.

(Testimony of Winston Albin Johnson.)

Q. And how did you get it—upon what terms?

A. I signed a short term note for the money.

Q. And did you get the money from your father?

A. Yes, I did.

Q. You actually got the money on your note?

A. Yes.

Q. What did you do with that money?

A. I then saw to it that it was deposited in the firm of the Western Construction Company.

Q. Did you receive any certificate, like a stock certificate, or any other evidence of your interest in the partnership?

A. No. The only thing I knew about it was that I had a note holding over my head to pay for that note.

Q. Now, in negotiating for this note were there any special arrangements about the note, or its payment or non-payment made with your father?

A. Well, my father and the other two brothers are not the type of business men that make ventures like that. I have always had to back up the things I did. If I borrowed the [304] money, I always had to pay them back, and it was understood clearly that this was a venture that I was taking a gamble in, and I would be responsible for this note, because after all, it was explained to me, that the note was for a credit and would actually be used.

Q. Did you have any connection with Coulee Dam?

A. Yes, I did. I worked there myself.

(Testimony of Winston Albin Johnson.)

Q. Did you know what happened over there?

A. Yes.

Q. I mean financially to the partners.

A. Yes, I do.

Q. Or did you at the time that you signed this note? A. Oh, yes.

Q. Now, when you separated from the service and came back home, what did you do for employment?

A. I worked in the office, and did the estimating and the pricing on various jobs. We did a good deal of figuring. We figured as many as two or three jobs a week. Sometimes it was not that many, but I can remember that we did figure that many a week.

Q. When you say, "Figuring," what do you mean by that? Will you explain to the Court what you mean by figuring a job.

A. We took off the quantities and would estimate the actual cost—what we thought that we could do that job for. In other words, with our experience so early in the game, we [305] have learned that a man can do so much work in so many hours' time. And after we had taken off the quantities, the lumber and the steel and the different materials that went into the job, we would sit down and from our past experience we would figure out the cost of what this work would amount to. Most estimators that work for a general contractor only do the estimating. The contractor does not take the man into consideration when he has been figuring the actual

(Testimony of Winston Albin Johnson.)

cost. All that he does is compute quantities, but with our experience we were able to sit down and actually figure out what a man could do per hour on a square foot of form, or digging a hole, and so forth.

Q. Now, is that all the work you did?

A. No.

Q. Estimating, taking off the quantities and pricing?

A. No. After we got the jobs we actually went on the job and helped——

Q. (Interposing): I mean you yourself. Tell the Court just what you, yourself, did.

A. Well, for instance we had no connection with the Navy. Many of our contracts were with the Navy, and I did the corresponding and the writing between the Navy and ourselves, and many of the decisions that we made on the conclusions of jobs, I wrote the final letter of submittal.

Q. Well, tell the Court a little about that. [306] You testify that you wrote letters to the Navy covering the final letter of submittal. Just give the Court some illustrations as to what that covered.

A. Well, as to one particular letter—this is the latest one here—we had a job on the water cross-connection system. I was working with Mr. J. A. Johnson on that particular job, and that job was cancelled after we had already made a start on it. And there had been considerable information acquired, and of course that had to be submitted as to what we had done, and what work was uncom-

(Testimony of Winston Albin Johnson.)

pleted, and what the company had actually put out in the way of making payments. There were actual disbursements. For instance, there would be conflicts between the Navy and ourselves on the job, which every contractor has, and I would enter into the meetings and help discuss the points and arbitrate these points over with the Navy.

It so happened that when a job was finally signed, or we received a job from the Navy, we would appoint a certain individual to take care of that job. Like Mr. J. A. Johnson would be the representative of the three partners in that partnership, and he would take care of most of the details. So his signature would be on most of the papers of any importance. But then there was a board selected all the time when these disputes would come up. When there was some question about the cost or a particular operation, or some [307] question of an extra on the job, or more work added to the job, this board would meet and come to an understanding as to terms in the amount of money.

Q. When you talk of "Board," whom are you talking about?

A. The Navy represented itself by three members, and we would represent ourselves by one of our members, and then myself.

Q. Is that what you mean by "The Board"?

A. Yes, sir.

Q. All right. Go ahead.

A. During this particular time we had other estimators—another estimator in our office, but he

(Testimony of Winston Albin Johnson.)

was not taken into these board meetings, or into any of these directors' meetings—not directors' meetings, but meetings with the Navy. In other words, he was purely a man for figuring quantities, and that was his job, and when 4 o'clock came around, he went home. And I myself received an actual salary at the end of each week to get along on.

Q. What was that?

A. It was about $80 a week, and I was not satisfied with it, but I realized that I could watch my investment this way and make my investment grow. And I spent many, many hours outside of the office that I was never paid for. It was not on an hourly rate. It was by the week. and it was enough so [308] that I could get along, but I did spend a good deal of time after office hours, and Saturdays and Sundays and times when everybody was home or going fishing, or doing other things like that.

Q. And that was with or without compensation?

A. With no compensation.

Q. What about sub-contracts on these jobs while you were in the office?

A. Well, it was up to myself to arrange so that we could get the proper sub-contracting. That was quite a job in itself, but most of our bidding depended upon a good sub-contract. A good deal of the work was to see that I got the proper figures on sub-contracts.

Q. And who had charge of letting the sub-contracts on the jobs that you have testified you took off the quantities?

(Testimony of Winston Albin Johnson.)

A. Well, myself. We had figured it, and we knew it. So we were the ones which determined which ones it would be—which electrical contrtctor and which plumber it would be.

Q. How long, Winston, after you separated from the Service were you with the limited partnership—the Western Construction Company?

A. I have been there since that time. In fact, I was there up to about—oh, I guess to about a year ago, and we at that time started another organization.

Q. The Glacier Construction Company, [309] Incorporated?

A. That is right.

Q. Referred to here? A. Yes, sir.

Q. And now, on this second limited partnership, formed the next year, will you tell the Court whether any of your sisters were taken in into the second partnership?

A. Yes. My youngest sister, Vedola Kent, was taken in at that time.

Q. Will you tell the Court the circumstances under which she was admitted to an interest in the limited partnership?

A. Well, my sister Vedola kind of felt that she was out of the picture, and she felt that the opportunity that had been given Elsie and myself was not given her, and with the pressure brought to bear that she put upon us, why my sister Elsie and myself decided that we would allow her to come into the partnership. And we did this, by receiving

(Testimony of Winston Albin Johnson.)

our $10,000 notes back and we wrote out another note for less money. And by that way we were able to get our sister in and allow her to have an equal opportunity, the way that we did.

Q. And what was the amount of these second notes?

A. Well, it was an easy amount to know—it was $6,666.66.

Q. And what about Vedola? Was she married at that time? [310]

A. When she signed the note she was engaged to a young man who was in the Service. He was a Chief in the Navy.

Q. And what was her age?

A. She was 21. She was of age. We did not allow any of the limited partners to come in until they were of age, so that they would have some responsibility.

Q. What was your age when you signed the note in 1942?

A. I must have been—I was born in 1919.

The Court: 23?

The Witness: 23—yes. Thank you.

Q. (By Mr. Potts): Now, go on from the second partnership, and you have told us about the Glacier Construction Company, Incorporated.

A. Yes.

Q. Did you subscribe for any stock in this construction company?

A. In the Glacier Construction?

Q. Yes. A. Yes, we did.

(Testimony of Winston Albin Johnson.)

Q. Well, did you? A. Yes, I did.

Q. And who else?

A. My sister—both sisters, and my father and my mother. [311]

Q. And did you pay for that stock?

A. We paid for it—yes, we did.

Q How much did you pay for your stock in the Glacier Construction Company?

A. Well, the exact figure I don't know, but it was around $37,000.

Q. Where did you get the money?

A. I got it from my interest in the Western Construction Company. I left some of it there, too, by the way. I didn't take it all.

Q. And did you pay that in cash to the Glacier Construction Company, Incorporated?

A. Yes, we did.

Q. Do you know whether your sister Vedola did the same? A. I am sure that she did.

Q. And Elsie Kent? A. Yes.

Mr. Potts: Would you mark this, Madam Clerk, as an exhibit?

The Court: It will be marked for identification Petitioner's Exhibit 16.

(Document above referred to marked Petitioners' Exhibit 16 for identification.)

Q. (By Mr. Potts): I show you, Winston, Petitioners' Exhibit 16 marked [312] for identification. Will you examine that exhibit and tell the Court, if you can, what it is.

(Testimony of Winston Albin Johnson.)

A. It is a list of my investments and my withdrawals.

Q. And that is supported by these checks (indicating), is that right?

A. Yes. These are the cancelled checks.

Q. All right. Now, would you give the Court or, refreshing your memory from this exhibit, if necessary, the amounts of your investments, earnings, withdrawals and dates.

A. On May 7, 1942, I made the investment of $10,000.

On December 31, 1942, the share of the profits was $35,615.92.

June 30, 1943, the share of the profits was $17,-918.80.

On June 30, 1943, the reduction in the investment was $33,330——

Q. (Interposing): Are you sure that it was $33,000? A. I beg your pardon. $3,333.33.

On December 31 the share of the profits was $7,718.17;

On December 31, 1944, the share of the profits was $2,767;

On December 31, 1945, the share of the profits was $7,591.66, making a total $78,279.22.

Q. Now, will you give me the withdrawals?

A. The withdrawals were as follows:

March 15, 1943, $4,434.76; [313]

June 15, 1943, $4,434.77;

September 13, 1944, $4,434.76.

Q. May I interrupt you to ask if those particu-

(Testimony of Winston Albin Johnson.)

lar withdrawals were for the purpose of paying the income tax on your earnings?

A. Yes, they were—these withdrawals were.

September 13, 1943—I said September 13, 1944, but it should be September 13, 1943, $4,434.76.

Q. And now, will you give the amount and the purpose of the next withdrawal?

A. On October 25, 1943, I drew out $275, which was for the purpose of purchasing an engagement ring.

Q. Just give us the next one, if you will.

A. On December 9, 1943, to the Collector of Internal Revenue, $4,434.76.

Q. And the next one.

A. January 6, 1944, my engagement was a success, and I went on a honeymoon, and I drew $1,000.

Q. All right.

A. On May 13, 1944, for the Collector of Internal Revenue, $600;

May 15, 1944, for the Collector of Internal Revenue, $1,280.51;

On May 15, 1944, for the Collector of Internal Revenue, $12.80; [314]

On June 14, 1944, for the Collector of Internal Revenue $600; and on June 20, 1944, I had a withdrawal of $508.50, which was part of my mother's funeral expenses.

Q. Your mother and father were separated some time before her death?

A. Yes, they were. And also on June 13, 1944, additional funeral expenses are $525.

(Testimony of Winston Albin Johnson.)

Q. Will you tell the Court—well, I think these speak for themselves. Go ahead.

A. On June 12, 1944, another additional amount for the funeral expenses was $25.

On September 13, 1945, for the Collector of Internal Revenue, $600;

On June 11, 1945, for the Collector of Internal Revenue, $600;

On March 13, 1945, for the Collector of Internal Revenue, $1,672.08;

And on March 23, 1945, a cash withdrawal of $880;

And on December 21, 1945, a cash withdrawal of $200.

Q. Those were your personal withdrawals?

A. Yes, they were, making a total of $26,517.94.

Q. Will you take the next year?

A. On December 31, 1946, my share of the profits was then $28.22. Do you want this as well (indicating)?

Q. No, that is just a subtotal. [315]

A. On February 14, 1946, there was a withdrawal of $281.17; and on March 2, 1946, I purchased a lot, and I withdrew $2,700.

Q. You mean that that was a building lot?

A. Yes, sir.

Q. A piece of real estate?

A. It was a lot on which we built a house.

Q. Yes.

A. On March 14, 1946, I withdraw $300 personally, and on June 18, 1946, I made a cash withdrawal of $7,000.

(Testimony of Winston Albin Johnson.)

On December 31, 1946, I made a cash withdrawal of $500.

On March 14, 1947, I made a personal withdrawal of $36,509.79.

Q. You say that you purchased a piece of real estate, "On which we built a house." Did you mean the partnership built a house on it, or that you, personally, did that?

A. Well, personally.

Mr. Potts: We will offer Petitioners' Exhibit 16 in evidence.

Mr. Payne: No objection.

The Court: It will be received as Petitioners' Exhibit 16.

(Document heretofore marked Petitioners' Exhibit 16 for identification, received in evidence.) [316]

PETITIONERS' EXHIBIT No. 16

Winston Johnson

Jan. 1942 to Dec. 31, 1945.

5/ 7/1942	Investment	$10,000.00
12/31/1942	Share of profits	35,615.92
6/30/1943	Share of profits	17,919.80
6/30/1943	Reduction in investments	3,333.33
12/31/1943	Share of profits	7,718.17
12/31/1944	Share of profits	2,767.00
12/31/1945	Share of profits	7,591.66
		$78,279.22

(Testimony of Winston Albin Johnson.)

Withdrawals

3/15/1943	Collector of Internal Revenue	$ 4,434.76
6/15/1943	Collector of Internal Revenue	4,434.77
9/13/1943	Collector of Internal Revenue	4,434.76
10/25/1943	Cash to buy engagement ring	275.00
12/ 9/1943	Collector of Internal Revenue	4,434.76
1/ 6/1944	Cash used on honeymoon	1,000.00
4/13/1944	Collector of Internal Revenue	600.00
5/15/1944	Collector of Internal Revenue	1,280.51
5/15/1944	Collector of Internal Revenue	12.80
6/14/1944	Collector of Internal Revenue	600.00
6/20/1944	Johnson and Sons Funeral Parlors (Mother's funeral)	508.50
6/13/1944	Acacia Memorial	525.00
6/12/1944	Rev. Emil Friborg	25.00
9/13/1945	Collector of Internal Revenue	600.00
1/11/1945	Collector of Internal Revenue	600.00
3/13/1945	Collector of Internal Revenue	1,672.08
3/23/1945	Cash withdrawal	880.00
12/21/1945	Cash withdrawal	200.00
		$26,517.94

Winston Johnson

Jan. 1, 1946, to Dec. 31, 1947.

Balance forwarded		$78,279.22
12/31/1946	Share of net profit	28.22
		$78,307.44
Amount of withdrawals brought forward		$26,517.94
2/14/1946		281.17
3/ 2/1946	Money used to purchase lot for residence	2,700.00
3/14/1946		300.00
6/18/1946	Cash withdrawal	7,000.00
12/31/1946	Cash withdrawal	500.00
3/14/1947	Personal withdrawals	36,509.79
		$73,808.90

Admitted May 25, 1948.

Q. (By Mr. Potts): I will just ask you generally, did you ever attend any meeting of the lim-

(Testimony of Winston Albin Johnson.)

ited partners, as a part of the work of the partnership? A. No.

Q. Do you know whether there was any committee, or board, or trustees, directors or anything of the kind ever elected? A. No, there was not.

Q. Do you have any evidence of your interest in this partnership other than the articles of co-partnership? A. Just that. No other evidence.

Mr. Potts: Your witness.

Cross-Examination

By Mr. Payne:

Q. Mr. Johnson, you testified on direct that the purpose of the limited partnership was to obtain larger capital; and larger capacity for doing business, is that right? A. Yes.

Q. In what way did that enable the business to get larger capital?

A. Well, I should probably have said larger credit. I mean to say larger credit.

Q. Now, what do you mean by that? You mean by the notes which the children gave to their fathers? [317] A. Yes.

Q. That is all you mean by that?

A. Well, credit also in the fact that we were a larger organization. We had more members that did more vital work that made us—well, I used to look at the Austin Company, and looked at the large force that they had, and the large capacity that they had for doing work, and with our members in

(Testimony of Winston Albin Johnson.)

the firm, why we could do the same. We had a larger standing force of men who were actually interested in the company.

Q. You didn't ever use your personal credit for purposes of the partnership, did you?

A. How do you mean?

Q. Well, outside of the note you gave your father.

A. I still don't understand. Did I use my notes——

Q. (Interposing): In the operation of the partnership business, you did not use your personal credit outside of the giving of your note to your father for your stated investment.

A. I think that that is right.

Q. How was the capacity enlarged? You were working with your father before 1942, weren't you?

A. Yes, sir. Well, if I hadn't gotten into the company I would not have stuck around. I was not interested in being with this company unless I actually had a direct [318] interest, the way I have now. I would have gone some place else and worked there, and the only reason why I stayed around was for my own interest.

Q. Now, it did not enlarge the capacity by getting Lloyd's services, did it?

A. Yes, it did. It increased by my being in it too.

Q. What?

A. It increased my capacity by having me and Lloyd and Roy in the company.

(Testimony of Winston Albin Johnson.)

Q. You have heard the testimony that Lloyd has given about his work with Kuney-Johnson, beginning in 1941? A. Yes.

Q. And up to the present time? A. Yes.

Q. And that he never devoted a considerable time to the partnership.

A. But he did. I mean, it was considerable—the amount of work that he did for us was so valuable that we could not have gotten along without it. We used it. It was some information that we could never have gotten any place else. We did use his capacity.

Q. You did get along without him before that, didn't you?

A. Well, yes, but we actually used him when we needed him. [319]

Q. You know that he spent some time away from Seattle, and during that time the partnership got along, didn't it?

A. Well, that is true of any of the members. My father went on hunting trips up to Canada and left everything in my hands, for instance, and we managed to get along all right. It was only for a short time.

Q. Now, you have heard the testimony of Roy, that he devoted about a year and a half to the partnership all told?

A. Yes. That is a very good service, however.

Q. How about the girls. Let me see. There were seven girls in the first partnership, I believe, is that right? A. That is right.

(Testimony of Winston Albin Johnson.)

Q. That enlarged the capacity just in the division of the income only, didn't it?

A. No. I think that our testimony will show that the interest or the capacity was increased by the fact that each of the girl's spouses was drawn closer to the company, and we were able to—there were several members there—like Mr. Ellingson, that actually came to work for us and had an interest in the company.

Q. Mr. Ellingson worked just as a regular carpenter, didn't he? A. He was a foreman.

Q. What about your sister Mrs. Keil—what is her name? [320] A. Elsie Keil.

Q. Is she your sister? A. Yes.

Q. How did that enlarge the capacity of the partnership?

A. Well, Mr. Keil is a painter by trade, and a very good one, in fact. I understand that he is working for the Jacobson Company—for Jacobson, a painting contractor here in the city at the present time, and his work is connected with our work, and he could at any time been of some help to us.

Q. But he never did work with you?

A. He never did.

Q. And Elsie never did?

A. Elsie worked for the company at times. She has.

Q. When?

A. She worked for my father, taking stenographic work from him, and so forth. And I know

(Testimony of Winston Albin Johnson.)

that she has helped in the office, and so forth, without any consideration whatever at all.

Q. When?

A. The exact years I cannot say—I know it was, however, during our Coulee Dam experiences, and I think that even since the partnership has been organized I have seen her in the office. [321]

Q. You have seen her in the office?

A. Yes.

Q. How long did the marriage between her and Keil continue?

A. Well, I am not so sure, but I think it was about eight years, or somewheres near there.

Q. How long? A. About eight years.

Q. Eight years? A. I am not sure.

Q. Do you know whether or not they were divorced? A. Yes, they were.

Q. When?

A. Well, it was after the arrangements for this partnership were made, I can say that, but the exact date I don't know.

Q. Do you know whether he knew about your sister signing the note? A. Oh, yes.

Q. Was he asked to sign it, do you know?

A. No, because it was not necessary. If she signed it he was as much responsible as she was for that note.

Q. Is that your understanding? A. Yes.

Q. Is that your understanding of the laws of the State [322] of Washington? A. Yes.

(Testimony of Winston Albin Johnson.)

Q. Do you know what property they had at the time Elsie signed that note?

A. No, I really don't know. He was working steady. He had been working for this company for many years, and he was a sort of a foreman, or something for them.

Q. Do you know whether the question came up about that interest when they were divorced?

A. Well, I think—you mean the interest that Elsie had in the company?

Q. Yes.

A. Yes, I think that he—well, I am not too sure, but I think that he settled that. He turned over everything that he had to her.

Q. Did you ever talk to your father about that?

A. No.

Q. You never did? A. No.

Q. You say that they settled it. Do you think that Mr. Keil got any of it?

A. Well, up to the time of his divorce he was benefiting by it—yes. He got some of the money.

Q. How? In tax payments?

A. No, no. Elsie paid a lot of her personal [323] bills from her interest.

Q. Do you know that? A. Yes.

Q. Where did you get your information?

A. I heard it from her—from Elsie.

Q. Is Elsie in the Courtroom?

A. She is not.

Q. She is not available, is she?

(Testimony of Winston Albin Johnson.)

A. No, she is not. She is in the hospital, flat on her back.

Q. But when they came to divide their marital—when they came to dissolve their marital relationship, you do not think that he got anything?

A. No, he did not. He signed a waiver of all the rights he had with Elsie.

Q. Well, now, you testified that you knew Elsie got some money to pay bills with. Do you know when?

A. Well, yes. I can say it this way that I know that Rudy—Elsie's husband—made his return with Elsie, and I believe the Western Construction Company paid his income tax.

Q. So that is the way you say that he got the benefit? A. Yes, I think so.

Q. As a matter of fact, Elsie never did draw much of anything, did she, in 1942, 1943 or 1944?

A. Well, I do not know about her personal affairs. [324]

Q. All right. What kind of work did you do for the partnership in 1942?

A. I have explained it very well. I was——

Q. (Interposing): You were very general. You didn't even identify it as to a year so far as I recall. Now, what were you doing in 1942?

A. Well, let me see. In 1942 I think—I was trying to figure on what job I was working on.

Q. Weren't you working in the office at the beginning?

(Testimony of Winston Albin Johnson.)

A. Yes. Part time, and part time on the job at the very beginning.

Q. What kind of work did you do in the office?

A. Estimating and office work, like I explained, figuring computations.

Q. You don't do your estimating in the office, do you? A. Oh, yes.

Q. Do you? A. Yes.

Q. That is what I wondered about. Didn't you drive a truck part of the time?

A. Well, I will tell you this, we did everything. My father and the rest of them drove trucks so that the unions were after them. We had so much trouble with getting men to be able to do things that we wanted them to do, that I know that my dad himself once in a while had to jump into a truck [325] and get it moving so that we could expedite our work.

Q. How much of your time in 1942 would you say that you did estimating, and how much of your time on other work?

A. Oh, about half and half.

Q. What about 1943?

A. I believe I was in the office most of the time, but then in 1943 we were building a flight service building in Renton for the Boeing Aircraft Company, and I helped supervise that work, and I was in the office too.

Q. And how about 1944 and 1945?

A. I believe I was entirely in the office all those times.

(Testimony of Winston Albin Johnson.)

Q. Were those estimates done on jobs that your father had supervision of?

A. No. Every job. We figured all of them.

Q. You heard the testimony of Roy that each one of the general partners had supervision of certain parts of the work. Now, is that your understanding? A. Yes.

Q. And the work that you did would be under the general direction of one of the general partners?

A. Yes, that is right.

Q. Who checked your work?

A. Well, nobody did.

Q. Nobody checked your work? [326]

A. Why would they?

Q. I am just asking you. No one checked your work you say? A. No one checked my work.

Q. Now, you heard Roy say that his work was checked by his father, didn't you?

A. Yes, but I do not think that he meant just exactly that. To go over his work and checking it would be doing the thing twice.

Q. Well, were you on a different plane than Roy? A. No, we were put on the same plane.

Q. How much were you getting in compensation in 1941, do you remember?

A. Oh, about the same. It was about $80 a week, I think.

Q. From the partnership? A. Yes, sir.

Q. Did that scale continue during 1942, 1943, 1944 and 1945? A. Yes, I think it did.

(Testimony of Winston Albin Johnson.)

Q. Did you get an increase?

A. I seem to remember that my checks were $90 a week at one time there. I think towards the end it went to $90 a week.

Q. Wasn't $80 a week a fair salary in 1941 and 1942? [327]

A. Well, not for what I was doing. In other words, I was there merely because of my interest.

Q. You didn't have an interest in 1941. So why did you stay there at $80 a week?

A. Because I contemplated going into the firm.

Q. Did anybody offer you a job?

A. Why, sure. I think that I could go anywhere any get more money for what I was being paid for.

Q. Where?

A. From any contractor in the city. I will tell you this, estimators were hard to get. You could get men who would not take an interest in their work, but to get good men that would actually put in more than ordinary business hours, that was a hard thing to do.

Q. Did you get a better offer?

A. I never went out to look for a better offer.

Q. How many estimaters did the Western Construction Company have?

A. There were—they would come and go. They lasted about six months maybe at a time, and then there would be another one.

Q. Can you remember any in 1942?

A. In 1942 I think that we had a George Piper. I am not sure. I think it was Mr. George Piper.

(Testimony of Winston Albin Johnson.)

Q. How much did the partnership pay [328] him? A. About the same.

Q. The same as you? A. Yes, sir.

Q. Do you remember how many you had in 1943, or whether you had any?

A. We had—let me see. We had another fellow, Ellinsong—I forget his name.

Q. Well, without going into details, did you pay them about the same scale?

A. Yes, just about the same scale. I believe that they were—I believe that they were paid better than I was.

Q. You don't know specifically, however?

A. No, not offhand, no.

Q. Did some of them have better qualifications than you had? A. No.

Q. Who fixed this amount of salary that you were paid there?

A. Well, it was amounts that I could get along on, and I didn't want the company to be held up on both ends.

Q. That is what you said on direct examination, Mr. Johnson, but who fixed that? Did the general partners fix the compensation of everybody who worked for the partnership?

A. Yes, they did. [329]

Q. Did you ever ask them for a raise?

A. I never did. I am not meaning that I was satisfied with that. I did that because of the interest that I had.

(Testimony of Winston Albin Johnson.)

Q. You said that Vedola, your sister, signed her note before her marirage. A. Yes, I did.

Mr. Payne: That is all.

Mr. Potts: Madam Clerk, would you mark this, please?

The Court: Mark this for identification as Petitioners' Exhibit 17.

(Document above referred to marked Petitioners' Exhibit 17 for identification.)

Redirect Examination

By Mr. Potts:

Q. Counsel has asked you about your sister Elsie. What is her present name?

A. It is Elsie F. Mathewson.

Q. And where is she residing now?

A. She is at Sea-View, Washington, now.

Q. And Counsel asked if she could be here. Showing you Petitioners' Exhibit 17 marked for identification, will you tell the Court what that is?

A. This is a doctor's opinion that my sister is in——

Q. (Interposing): Just tell us what it is. It is a doctor's what?

A. It is written on a prescription blank really, but it is a doctor's statement that Elsie——

Q. (Interposing): It is a doctor's statement, is that correct? A. Yes, sir.

Mr. Potts: I will show it to Counsel. (Handing

(Testimony of Winston Albin Johnson.)

document to Mr. Payne.) We offer this in evidence if the Court please.

Mr. Payne: No objection.

The Court: It will be received as Petitioners' Exhibit 17.

(Document previously marked Petitioners' Exhibit 17 for identification, received in evidence.)

Mr. Payne: I would just like to say, Your Honor, knowing that condition, that is the reason that I asked this witness the question that I did about his sister, because I understood that he was personally familiar with some of the phases of her activities.

The Court: I see.

Mr. Payne: And knowing that she would not be here, that is the reason I asked him.

Q. (By Mr. Potts): Just one thing. I think Counsel asked you if there [331] were seven girls in the first partnership. Is that correct?

A. I didn't stop to count them up.

Q. Will you tell us how many there were in the first partnership?

A. I will have to use my fingers here.

Q. Were there four in the first partnership?

A. Yes.

Q. And seven in the second?

A. That is it.

Mr. Payne: I stand corrected on that. That is right Your Honor. I was thinking of the second partnership.

The Court: All right.

Mr. Potts: Will you step down then, Winston.

(Witness excused.)

Mr. Potts: I would like to recall Mr. Lloyd Johnson on a brief examination of something that I overlooked.

The Court: Very well. You may do so.

Whereupon,

LLOYD W. JOHNSON

a witness previously called on behalf of the Petitioners, was recalled for further examination, having been previously sworn, testified as follows:

Direct Examination

By Mr. Potts:

Q. You are Lloyd W. Johnson, are you [332] not? The same Lloyd W. Johnson who was on the stand before? A. Yes, sir.

Q. And you have been sworn previously, is that right? A. Yes, sir.

Q. Lloyd, while you were with Kuney, as you have testified, did you have any business relationships with Western Construction Company as representing not yourself alone personally, but the firm of Kuney-Johnson?

A. Yes. We had several deals.

Q. Will you describe them to the Court?

A. The Kuney-Johnson Company would work with the Western Construction Company. We bid on an Army pier down here at Pier D, I think that

(Testimony of Lloyd W. Johnson.)

is the designation of it, and we bid that as a joint venture with the Western Construction Company.

Q. Do you recall about what year that might have been?

A. That must have been about 1943, maybe.

Q. Were there any other bids made that you remember between you?

A. We several times approached the Navy on some what they call CPFF jobs, or cost plus fix fee jobs, where we had to combine our resources to get this work. The Navy, it seemed, at that time was reluctant to just give one contractor, unless he was a very large concern, some of this work that had to be done in a great hurry. One job I remember specifically [333] was the Lighter-than-Air Base at Tillamook, Oregon. We received a lot of consideration on that job, right up until the end, when the Sound Construction Company got the job.

Q. The point is, was the Western Construction Company—the limited partnership—involved with Kuney-Johnson——

A. (Interposing): Yes, that is correct.

Q. (Continuing): ——in the attempt to get these jobs?

A. That is correct. The Western Construction Company and the Kuney-Johnson Company combined forces.

Q. And who was directing that effort to get those jobs?

A. I was directing most of the effort.

Q. Now, you mentioned about how two com-

(Testimony of Lloyd W. Johnson.)

panies would get together for the purpose of getting these Navy jobs. A. Yes, that is correct.

Q. Would you tell the Court whether or not in that connection any kind of a report, or statement, or representation was required to be made to the Navy as to personnel?

A. We had to qualify our—you just don't walk in to the Navy and tell them that you want to take a four million dollar job. You have to present your qualifications. These qualifications were all presented to the Navy on a combined statement listing all personnel that were to be available for the job, and the type of work that they did, and the [334] experience of each one of them and the record behind each one. It is a pretty comprehensive report that is required by both the Army and the Navy for any work of that nature.

Q. And by that, did it not include the educational background of the men?

A. Yes. It included all their qualifications, educational, experience record, and everything.

Mr. Potts: Your witness:

Recross-Examination

By Mr. Payne:

Q. You said that you directed that joint venture work which Kuney-Johnson and Western took together.

A. You misunderstood me. We attempted—this was one of our successful ventures. We attempted

(Testimony of Lloyd W. Johnson.)

to get joint venture work together, and we didn't on Pier B, or on Pier D, rather, because we were the second low bidder. The General Construction was the low bidder. And on the Tillamook Air Base we received consideration right up to the very last, and then the job was finally awarded to Sound Construction Company and Peter Kewitt.

Q. So you never did take any work together?

A. We never did take any work together, but we did the preparatory work together.

Q. You said that you listed the personnel to the Navy. That means just the partners, is that [335] right?

A. We listed all the personnel that we had.

Q. What do you mean by that, the supervisors, the estimators and engineers and all the personnel working with the respective partnerships?

A. We listed all the people that were available from both of our organizations.

Q. I see. That would be available on that particular job. Whether on a salary basis or whether partners——

A. (Interposing): That is right.

Q. Or no matter what the basis was?

A. Yes, sir.

Mr. Payne: That is all.

Redirect Examination

By Mr. Potts:

Q. Do you remember whether or not Roy John-

(Testimony of Lloyd W. Johnson.)

son and/or Winston Johnson were listed on any of those personnel reports?

A. Yes, I am positive that they were. I am positive that Roy, Winston and myself were. There was no reason why we should leave them off.

Mr. Potts: Thank you. That is all.

Mr. Payne: That is all.

The Court: We will now recess until 2 p.m.

(Whereupon, an adjournment was taken at 12:20 o'clock p.m., May 25, 1948, to 2 o'clock p.m. of the same day.) [336]

2 P.M., May 25, 1948

(Whereupon, the trial was resumed pursuant to adjournment.)

Mr. Potts: I will call Mr. Ogg.

The Court: Very well.

Whereupon,

WESLEY OGG

called as a witness on behalf of the Petitioners, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Potts:

Q. Will you state your full name, please?

A. Wesley Ogg.

Q. Where do you reside, Mr. Ogg?

A. Seattle, Washington.

Q. What is your occupation or profession?

(Testimony of Wesley Ogg.)

A. I am Credit Manager for the Seaboard Branch of the Seattle First National Bank.

Q. Now, I believe I interviewed you the other day, did I not? A. That is correct.

Q. And asked you to bring with you certain statements? A. That is correct.

Q. Have you those statements with you?

A. Yes. (Handing document to Mr. Potts.) [337]

Q. Now, have you another copy of this? May we use this and introduce this in evidence?

A. You may do that.

Q. This is the original duplicate, is it?

A. That is the original.

Mr. Potts: I will have this marked for identification.

The Court: It will be marked for identification Petitioners' Exhibit No. 18.

(Document above referred to marked Petitioners' Exhibit 18 for identification.)

Q. (By Mr. Potts): Showing you Petitioners' Exhibit No. 18 marked for identification, I will ask you to state to the Court what that exhibit consists of.

A. This is a financial statement given us and signed by Mr. J. A. Johnson as part of our confidential record files, in support of any accommodations of credit, or otherwise, he might request from us.

Q. And this is dated what?

(Testimony of Wesley Ogg.)

A. This is dated August 20, 1945, and was submitted to us on or about that date.

Mr. Potts: I would like to offer at this time, if the Court please, Petitioners' Exhibit 18 for identification in evidence. [338]

Mr. Payne: No objection.

The Court: It will be received as Petitioners' Exhibit No. 18.

(Document heretofore marked Petitioners' Exhibit 18 for identification received in evidence.)

Mr. Potts: I might state to the Court that the purpose is on account of this item of $20,000, accounts and notes due from friends and relatives, I believe is the way that the statement reads.

The Court: Yes. All right.

Mr. Potts: Your witness.

Cross-Examination

By Mr. Payne:

Q. Are you personally familiar with the facts and circumstances relating to that statement?

A. No, I am not.

Q. You just know that it came from the files of the bank? A. That is correct, yes.

Q. Do you know whether any personal investigation was ever made with reference to this $20,000 item listed as accounts and notes receivable from relatives and friends?

A. Not to my knowledge.

(Testimony of Wesley Ogg.)

Q. This purports to be the statement of J. A. Johnson, [339] does it? A. Yes.

Q. Do you know whether any loan was made based on this statement?

A. I don't know. I didn't check the records.

Q. You do not know whether a loan was even asked for, do you, whether in the name of the partnership or in the name of an individual?

A. No, I do not.

Mr. Payne: That is all.

Mr. Potts: That is all.

(Witness excused.)

Mr. Potts: I will call Mr. Lake.

The Court: Very well.

Whereupon,

M. B. LAKE

called as a witness on behalf of the Petitioners, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Potts:

Q. Will you state your name and address, please?

A. My name is M. B. Lake, and I reside at 2822 - 31st Avenue South, Seattle, Washington.

Q. What is your occupation or business, Mr. Lake?

(Testimony of M. B. Lake.)

A. I am assistant comptroller of the Seattle First [340] National Bank.

Q. At my request did one of the officers of the bank ask you to be ready to bring to us today some records in the possession of the bank?

A. I brought with me the partnership signature cards requested by yourself.

Q. Thank you. And was your bank kind enough——

A. (Interposing): There are copies of them here also.

Q. (Continuing): ——to have duplicates made?

A. Yes, sir.

Q. So that we can have them identified?

A. Yes.

Mr. Potts: I think that we can staple these all together as one exhibit.

The Court: That will be marked for identification as Petitioners' Exhibit 19.

(The documents above referred to marked Petitioners' Exhibit 19 for identification.)

Mr. Potts: Thank you, your Honor, and the exhibit will consist of two cards and four sheets of paper.

The Witness: I think you have two copies of each one of those letters there.

Mr. Potts: Oh, are there two copies?

The Witness: Yes.

Mr. Potts: I am sorry. [341]

The Court: It is not necessary to have but one.

Mr. Potts: That is right, all we need is just one.

(Testimony of M. B. Lake.)

Then the exhibit will consist of two cards and two letters, if your Honor please.

The Court: Maybe the two cards are duplicates—are they?

Mr. Potts: No, they are not.

The Court: All right.

(Document above referred to marked Petitioners' Exhibit 19 for identification.)

Q. (By Mr. Potts): Mr. Lake, showing you the exhibit—these two letters and two cards have been compared, have they not, with the originals?

A. That is right.

Q. And they are a true and correct copy thereof?

A. Yes, sir.

Q. Now, tell the Court, if you will, what the two cards are, first.

A. This is a partnership checking account signature card of the Western Construction Company, signed or carried with the authorized signatures of George Johnson, Albin Johnson and J. A. Johnson.

Q. And the date?

A. The account was opened April 17, 1934; was closed [342] July 17, 1935; was reopened July 24, 1935, and was finally closed on March 17, 1947.

Q. And at that time, in 1947, were there any cards—was there another card with authorized signatures filed——

A. (Interposing): That is right.

Q. (Continuing): ——with your bank?

(Testimony of M. B. Lake.)

A. That is right. The signature card was merely a cancellation of authorization, and another signature card was substituted on the account. Also there was a partnership checking account, in which the signatures of Albin Johnson or Winston Johnson and George Johnson and J. A. Johnson were authorized on the account.

Q. Is that the only difference, the signature *or* Winston Johnson was added.

A. That is right. As I understand it, this next account that was opened, George Johnson and J. A. Johnson must sign all checks. In other words, three signatures are required on the second signature card, which was given effect from March 18, 1947, until the account was closed on September 19, 1947.

Q. And up to that time what signatures had been authorized to sign checks for the Western Construction Company, a co-partnership?

A. George Johnson, Albin Johnson and J. A. Johnson, with instructions to pay on their [343] signature.

Mr. Potts: We offer, if the Court please, Petitioners Exhibit 19 in evidence.

Mr. Payne: No objection.

Mr. Potts: Consisting of the two cards.

Q. (By Mr. Potts): Would you explain to the Court what the two letters were accompanying these cards?

A. The two letters relate to the transmittal of the signature card for our authorization file. The first letter is dated 1932 and pertains to a prior group

(Testimony of M. B. Lake.)

of signatures on this account. This letter dated April 26, 1934, pertains to the account which was opened on April 17, 1934, and I believe the letter itself is self-explanatory.

Mr. Potts: Yes.

The Court: It will be received as Petitioners' Exhibit 19.

(Document heretofore marked Petitioners' Exhibit 19 for identification received in evidence.)

Mr. Potts: Your witness, Mr. Payne.

Cross-Examination

By Mr. Payne:

Q. Did I understand you to say, Mr. Lake, that when that account was reopened—I will strike that question. Did I understand you to say that on the second card [344] authorizing Winston Johnson to sign after that date, the signature of all three was required on checks?

A. That is right, sir—yes, sir.

Q. And how long did that continue?

A. The account was closed September 19, 1947.

Q. When was the signature card with Winston's name on it given? A. March 18, 1947.

Mr. Payne: I see. That is all, thank you.

Mr. Potts: That is all. Thank you very much for coming up here.

(Witness excused.)

Mr. Potts: I will call Mrs. Gustafson.

Whereupon,

MRS. RACHEL DORIS GUSTAFSON

was called as a witness on behalf of the Petitioners, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Potts:

Q. Will you state your full name, please, Mrs. Gustafson?

A. Rachel Doris Gustafson.

Q. Where do you live, Mrs. Gustafson?

A. Route 3, Box 440, Issaquah, Washington.

Q. How long have you been a resident of King County, [345] State of Washington, Mrs. Gustafson? A. 39 years.

Q. And are you the daughter of George Johnson? A. Yes, I am.

Q. Are you married? A. Yes, I am.

Q. And what is your husband's name?

A. Leonard Gustafson.

Q. Now, Mrs. Gustafson, your mother's name was Amanda Johnson, wasn't it?

A. That is right.

Q. And can you tell the Court when she died—approximately?

A. Yes. She was killed by a hit and run driver in September, 1920, I think it was.

Q. September, 1920? A. Yes, sir.

(Testimony of Mrs. Rachel Doris Gustafson.)

Q. And what children did she leave at that time?

A. I was the oldest; and Lloyd and Bernice.

Q. Now, Mrs. Gustafson, directing your attention to—first of all, tell us when were you married?

A. I was married in March of 1928.

Q. You were married in March of 1928?

A. Yes, sir.

Q. What was Mr. Gustafson doing at the time of your [346] marriage? What was his work?

A. He was going to school.

Q. And what course was he taking?

A. Well, he was taking a pre-medic course, and then when we were—he had, I think, a year and a half or something like that in pre-med, and then when we were going to be married, my dad talked to him, and we talked it over and suggested that he might change to engineering. So he graduated in engineering three years after we were married.

Q. Could you tell us how Mr. Gustafson financed his college work?

A. Well, he worked some, and I worked some. I worked in the office of the Western Construction Company. And then my dad helped.

Q. How long did you work for the Western Construction Company?

A. Well, I worked there, I think, about a year and a half before I was married, and almost two years after—I mean two years before I was married and about two years after.

Q. Now, Mrs. Gustafson, directing your atten-

(Testimony of Mrs. Rachel Doris Gustafson.)

tion to the year 1942, and the limited partnership of the Western Construction Company, you are familiar with that, aren't you?

A. Yes, I am.

Q. Did you make an investment in the [347] Western Construction Company as a limited partner? A. Not in 1942.

Q. Oh, yes. Now, tell the Court, in 1942 did you have any discussions with anyone regarding the limited partnership of the Western Construction Company?

A. Well, we had—it was a family affair, but I was married, and we had three children, and when you have a family you think before you take a risk, and I didn't feel that we should go into anything like that then. My husband had gone into other business in the meantime and—well, we just didn't feel that we should.

Q. Now, you say "take a risk." Tell the Court what you mean by that. What kind of a risk did you mean?

A. Well, I was to give a note for $5,000. That would put my son through college, or we could do a lot of other things with $5,000, and I knew that when you signed a note you had to pay it. That when you sign a note that is your obligation.

Q. You didn't then go into the partnership in 1942? A. No, I did not.

Q. What about 1943? Did you go into the partnership at that time?

A. In 1943 my sister Betty became of age, and

(Testimony of Mrs. Rachel Doris Gustafson.)

the discussion was reopened, and we both went in together then at the same time. [348]

Q. How did you go in—on what basis?

A. Well, Bernice and Lloyd both had borrowed $10,000 from dad, and those notes were recalled and that amount of $20,000 was just—I assumed half of one of these $10,000 notes and made a note for $5,000.

Q. To whom was the note made?

A. To my dad.

Q. What did you get for the note?

A. I didn't get anything for the note. I gave the note that I owed.

Q. You got or you gave?

A. I gave the note to my dad.

Q. Didn't you get $5,000 that you invested in the limited partnership?

A. Well, that money—that was just——

Q. (Interposing): I am sorry. This is 1943.

A. You see, Bernice and Lloyd had each taken $10,000, and we divided that. Betty came in at the same time.

Q. Now, at that time, Mrs. Gustafson, can you tell the Court—oh, by the way, had you discussed this investment with your husband?

A. Naturally.

Q. Was he willing that you make the investment? A. Yes.

Q. After you made it how did you treat it with respect [349] to the material community consisting of yourself and Mr. Gustafson?

(Testimony of Mrs. Rachel Doris Gustafson.)

A. Well, we treated it as community property. It was his obligation as much as mine.

Q. However, I believe only you signed the note, is that correct? A. That is right.

Q. Now, what about your financial worth at that time, both from the community standpoint and your sole and separate estate. I am referring to the date when you signed the note.

A. Well, my husband had a business that was not shaking the world, but it was giving us a good living, and we could have taken care of the note very easily.

Q. Did you have some property of your own—that is, your own sole and separate estate at that time? A. Yes, I did.

Q. And what was the value of that?

A. Well, I cannot really say what the value of it might have been, but it was enough to take care of the note.

Q. And you owned your own home?

A. Yes.

Q. Where was your home situated at that time?

A. We lived at 3219 Magnolia Boulevard.

Q. And you sold that home recently, didn't you?

A. Yes, we did. [350]

Q. What did you sell it for?

A. Oh, I think it was for $23,500.

Q. And was that home clear at the time that you signed this note?

A. No, it was not. We had a small mortgage on it. I think—oh, I would not know the exact amount,

(Testimony of Mrs. Rachel Doris Gustafson.)

but it was around about $4,000 I would think, and we had low interest on the money, and the mortgage was written so that we could not pay more than so much in a year, and we didn't refinance it because we thought that it was just as well to have that money there.

Q. And your husband was in what business at that time? A. He has a meat market.

Q. Did he own it? A. Yes.

Q. Did he owe anything on it? A. No.

Q. Where is that market located?

A. It is located at 2002 Market Street in Ballard.

Q. Can you give us any idea of the value of that business at the time you signed this note?

A. You had better ask him. I would not know.

Q. Very well. We will ask him. Did you have any stocks or bonds.

A. Yes, I have stock in the company. It is a [351] corporation.

Q. The meat market is a corporation?

A. Yes.

Q. How much stock do you have in that company?

A. I think it is written up. He has 29 shares and I have 1.

Q. Did you have any bonds at that time?

A. Any government bonds?

Q. Yes.

A. I would not know, whether I did right then or not.

(Testimony of Mrs. Rachel Doris Gustafson.)

Q. Did you have any cash in the bank at that time, if you remember?

A. Oh, I am sure that we did.

Q. Can you give us any approximate amount?

A. My husband pays the bills. I would not know. You will have to ask him.

Q. You remember that you did have a bank account at that time? A. Oh yes.

Q. With money in it?

A. Yes. I wrote checks.

Mr. Potts: I will have this marked for identification.

The Court: That will be marked Petitioners' Exhibit 20 for identification. [352]

(Document above referred to marked Petitioners' Exhibit 20 for identification.)

Mr. Potts: I think, Mr. Payne, you have a copy of this.

Mr. Payne: Yes.

Q. (By Mr. Potts): Showing you Petitioners' Exhibit 20 marked for identification, Mrs. Gustafson, can you tell the Court what that is?

A. Well, this is a statement of my account at the Western Construction Company of the investment and the share in the profits and withdrawals.

Q. And that covers the years, does it, from 1943 to——

A. (Interposing): To 1946.

Q. To 1947, does it not? A. That is right.

Mr. Potts: We offer, if the Court please, Petitioners' Exhibit 20 in evidence.

(Testimony of Mrs. Rachel Doris Gustafson.)

Mr. Payne: No objection.

The Court: It will be received in evidence as Petitioners' Exhibit No. 20.

(Document heretofore marked Petitioners' Exhibit 20 for identification received in evidence.)

PETITIONER'S EXHIBIT No. 20

Rachel Gustafson

June 30, 1943, to Dec. 31, 1945.

Investment		$ 5,000.00
12/31/43	6 mos. profit	5,788.62
12/31/44	Share net profit	2,075.24
12/31/45	Share net profit	5,693.74
		$18,557.60

Withdrawals

9/15/43	$ 575.00
12/11	575.00
4/10/44	350.00
5/15/44	235.00
6/14/44	350.00
9/13/44	350.00
1/11/45	350.00
9/17/45	300.00
	$ 3,085.00

Brought forward		$18,557.60
12/31/46	Share of net profit	21.16
		$18,578.76

Withdrawals brought forward	$ 3,085.00
1/14/46	473.55
3/28/46	423.46
5/27/46	218.53
2/13/47	200.00
	$ 4,400.54

Admitted May 25, 1948.

(Testimony of Mrs. Rachel Doris Gustafson.)

Q. (By Mr. Potts): Mrs. Gustafson, you had an interest, did you not, [353] in your mother's estate? A. Yes, I did.

Q. Do you know what that estate consisted of?

A. Well, it consisted of a share in certain properties, and then an interest of a certain amount of Western Construction Company.

Q. And that was not distributed to you at the time that you signed this note?

A. No, it was not.

Mr. Potts: Your witness.

Cross-Examination

By Mr. Payne:

Q. Mrs. Gustafson, I didn't get clear the years that you worked for the Western Construction Company. What years were those?

A. Well, it was—I was married in 1928, and I think I worked there about two years before I was married, and two years afterwards.

Q. And by 1943, when you became a member of the limited partnership, you had a family, did you not? A. Yes, I did.

Q. You were not a member of the first partnership in 1942, were you? A. No, I was not.

Q. Why did you say that you were reluctant to go in at [354] that time?

A. Well, we had signed notes, and I have been the daughter of a contractor all my life, and we have lived with ups and downs, and I just didn't

(Testimony of Mrs. Rachel Doris Gustafson.)

know whether I was willing to risk $5,000, if they should lose it for me.

Q. Did you have some discussion about the 1942 partnership before the others signed up?

A. Yes, we did.

Q. Did they ask you to come in?

A. Yes, they did.

Q. And did you talk to your husband about it?

A. Yes, I did.

Q. And did he agree that you should do it?

A. Well, we both agreed that we should not do it.

Q. What changed your mind in 1943?

A. Well, the discussion was reopened, because Betty became of age. She was 21 then. She had not been old enough before to be in the partnership, and we were a little better off then than we had been in 1942.

Q. Did you have a discussion with your father about the thing? A. Yes, I did.

Q. Did he tell you that he expected to make good money in the partnership?

A. He didn't say how much he expected to make. [355] In fact, I do not think that any of his children have ever known how much our fathers made. I don't tell my children how much we make either.

Q. But did your father tell you that he expected to make some money in business so that that note would be paid off out of the business.

A. I think everybody hopes to make money

(Testimony of Mrs. Rachel Doris Gustafson.)

when he goes into business, don't they? Otherwise they would not go into business.

Q. Did your father ever talk to you about the possible effect of reducing his income tax in that way? A. Not one word.

Q. What did your husband say when you were talking to him about signing a note in 1943?

A. He said that it was perfectly all right with him.

Q. Well, did you have any discussion between yourselves as to how you would treat that in your respective income tax returns—the income from the partnership?

A. No, I don't think that we talked about that.

Q. When it came time to prepare your income tax returns for 1944, covering the year 1943, what did you do? Did you prepare that?

A. No, I have never prepared an income tax return. Either our own bookkeeper has taken care of our own, and then they will prepare it at Western Construction Company for their [356] part.

Q. What do you mean by "For their part"? I don't understand that.

A. Well, I think our bookkeeper got all our records straight as to what our business had brought in.

Q. You mean you and your husband's business?

A. Yes, that is it.

Q. And then what do you mean about the Western Construction Company?

(Testimony of Mrs. Rachel Doris Gustafson.)

A. Well, they finished the report—completed it for us.

Q. For the amounts of the profits attributable to you from the partnership? A. Yes, sir.

Q. Did they ask you whether that was to go in your return or whether it was to go into your return and your husband's?

A. Well, I think we have always filed separate returns, my husband and I.

Q. Did you have any discussion with anybody from Western Construction Company, or any place else about what that was—whether that was yours or his? A. No.

Q. Your answer is, "No"?

A. My answer is, "No," that is right. [357]

Q. Did you have any separate property at the time that you married your husband in 1928—anything that belonged to you solely?

A. Well, I had that part of my mother's estate. There was property in that individual estate that belonged to me solely.

Q. Do you know how much that was?

A. I would not know.

Q. How did you learn about that? Did your father tell you? A. Yes, he did.

Q. You knew the difficulties that the partnership went through in 1935 and 1936, did you?

A. Yes, I did.

Q. You were old enough to remember that?

A. Yes, sir.

Q. That was after your marriage?

(Testimony of Mrs. Rachel Doris Gustafson.)

A. Yes, sir.

Q. And you had a family of your own?

A. Yes, sir.

Q. And you were conversant with conditions then, were you? A. Yes, sir.

Q. Your father never told you what that was, if any. A. What? [358]

Q. He never told you of the interest coming to you from your mother's estate, did he?

A. No, and I never asked him either.

Q. Did you have anything else at the time of your marriage? A. No, I did not.

Q. Did you acquire anything else by gift from your father, or from anybody else between then and 1943?

A. Well, I acquired some money through the sale of a piece of property. One of these properties that was listed at the time of my mother's death was sold, and I was given my share in that property.

Q. Do you remember how much that was?

A. I cannot say the amount, because it was not given to me—I didn't take it in money. I took it in a contract on a small house, and some bonds, and right now I cannot tell you what it was. I think it amounted to about $5,000.

Q. And that was in what year.

A. I would not venture to say what year. I cannot remember what year it was.

Q. Could you say whether it was before 1943 or after? A. It was before 1943.

(Testimony of Mrs. Rachel Doris Gustafson.)

Q. Where was the house—here in Seattle?

A. It was an apartment building here in Seattle.

Q. Your husband has been in the meat market business [359] for a long time, has he?

A. Ever since he came out of school, in 1931.

Q. Since you were married he went into that business?

A. He got out of school at the very bottom of the depression, and I do not think that there was one engineer that graduated in civil engineering that year that got a job in civil engineering. They all went into other things, and he had learned the meat business while he was going to school, and he got a job right away at that, and then bought the market within a few months—a half interest in it—and then within a short time he bought the other half interest.

Q. Do you know Mr. Von Harten?

A. No, I do not.

Q. You do not know Mr. Von Harten?

A. No.

Q. Coming back to your returns which were filed for 1943, and later, can you say now where your return was prepared, and who prepared it in final form? Was it prepared down at the offices of the Western Construction Company?

A. I suppose it must have been, in 1943.

Q. Do you remember going down there to sign the return for 1943?

A. Well, I have not always gone down there to

(Testimony of Mrs. Rachel Doris Gustafson.)

sign it. Sometimes it has been mailed out to us to sign, if it has been prepared in the office. [360]

Q. Have your returns customarily since 1943 been prepared by the Western Construction Company? A. That is right.

Q. And you say sometimes they would send the returns out to you for signature?

A. That is right.

Q. How would they get the information from you about your own business? Would you furnish that to them?

A. Well, our own bookkeeper gets that information ready, and we turn that part over to them.

Q. And then the Western Construction Company makes out the balance of the return?

A. That is right.

Q. Now, you testified concerning your capital amount in the Western Construction Company—Exhibit No. 20. A. Yes.

Q. You notice some withdrawals in there, Mrs. Gustafson, don't you, as of 9-15-43, $575? Do you know what that was?

A. I imagine it was income tax.

Q. You think all of those amounts appearing on that schedule under withdrawals were income tax?

A. I think they were all income tax. I have had no occasion to draw money. There has been no reason why I should not, but I just never have drawn any.

Q. And these checks which are made to you—take the [361] first one, September 15, 1943, at-

(Testimony of Mrs. Rachel Doris Gustafson.)

tached to your exhibit No. 20 for $575, do you know what you did with that check?

A. Well, that is made out to my husband and not to me. And I imagine that was for payment of our income tax—the portion that was the Western Construction Company's earnings.

Q. I call your attention to the next check, also made out to him on December 11, 1943, in the same amount, and I will ask you if that is also income tax. A. Yes, sir.

Q. You think all of these checks then do represent amounts that you received for payment of income tax? A. That is right.

Mr. Payne: That is all.

Mr. Potts: That is all.

(Witness excused.)

Mr. Potts: I will call Mr. Gustafson.

Whereupon,

CARL LEONARD GUSTAFSON

called as a witness on behalf of the Petitioners, was examined and testified as follows:

Direct Examination

By Mr. Potts:

Q. What is your name?

A. Carl Leonard Gustafson.

Q. And where do you reside? [362]

A. Box 444, Issaquah, Washington.

(Testmony of Carl Leonard Gustafson.)

Q. How long have you been a resident of the State of Washington?

A. Since 1907 I believe it is.

Q. And of King County?

A. The same length of time.

Q. Mr. Gustafson, what has been your education?

A. Well, I started out with pre-medics. I believe it was in about 1925, and went nearly two years in pre-medics. And then I believe it was in the Fall of 1927 that I began my engineering education.

Q. How did you happen to change from pre-medics to civil engineering?

A. Well, I had married a contractor's daughter, and that contractor, my father-in-law, was explaining to me the possibilities in the line of business that he was in, and looking forward to seven or eight years in medical school was kind of long, so at his request, and seeing the possibilities in that line, I decided to go into engineering.

Q. How did you finance your course in the University?

A. Well, I worked afternoons and Saturdays, and my wife was working, but that was not quite enough to make ends meet. My father-in-law helped me with the balance.

Q. And where was your wife working?

A. In the office of the Western Construction Company. [363]

(Testmony of Carl Leonard Gustafson.)

Q. Now, after you graduated—about what year, by the way, was it that you graduated?

A. I graduated in June of 1931.

Q. What about your engineering, when you graduated? Were you able to put it into any practical use?

A. Well, I had spent my summers when I was going to the University on various jobs for the Western Construction Company that they had.

Q. You had worked then for the Western Construction Company?

A. That is right. I think I worked three summers for the Western Construction Company to pick up what practical knowledge I got, along with my own school work. And when I was through school in 1931, we were then building the Albro Crossing at Georgetown, and Mr. Peterson was the foreman on that job, and I was timekeeper and assistant to him. And when that job was finished, in September I believe it was, the Western Construction Company didn't have any work in sight, and a friend of mine who had opened a new meat market asked me to go to work for him, and with my responsibilities I took that for the time being, and that changed things as far as my engineering future was concerned—construction future.

Q. And you remained, did you, with the meat market for some time? [364]

A. In the Spring of 1932 the man that I was working for was in financial difficulties and needed money, and so he asked me to buy a half interest,

(Testmony of Carl Leonard Gustafson.)

which I did. And I think it was about a year later after that that he wanted to sell out his half, so then I became sole owner together with my wife of the entire stock of the meat market.

Q. Is that a business that is incorporated—is that the business that is incorporated that your wife has testified to?

A. That is right. That is called the Fair Price, Incorporated.

Q. Where is the location of that market?

A. 2002 Market Street, Seattle.

Q. With reference to 1943, can you give us any ideas of the volume of business you did in that year?

A. Well, I would say roughly between $90,000 and $100,000 gross business.

Q. What would you say as to the size of your market compared to the average meat market?

A. Well, I would say that it was just about averaged. During good years I have had two men in my employ all the time, if not part of the time. Right now I just have one full-time man.

Q. Now, with reference to the limited partnership, directing your attention to the year 1942, you have heard your [365] wife testify, have you?

A. Yes.

Q. Can you tell the Court anything concerning the matter—particularly concerning the failure of entering into the agreement at that time?

A. Well, I was perhaps a little reluctant because I had had experience with a partnership. I

(Testmony of Carl Leonard Gustafson.)

had had a partner myself, and I knew the obligations that went with a partnership, and perhaps that was one reason why she was reluctant too.

Q. At any rate, you didn't go in at that time?

A. That is right.

Q. Is that correct? A. Yes.

Q. Now, with reference to the year 1943 did you or Mrs. Gustafson enter the partnership at that time? A. Yes, she did.

Q. Did she discuss the matter with you before entering the partnership? A. Yes, she did.

Q. Did her entrance into the partnership have your approval? A. Yes, it did.

Q. Now, what about this note? Did you know that she was going to sign a note? [366]

A. Yes, I did.

Q. In order to enter the partnership.

A. Yes, sir.

Q. Were you agreeable to her signing a note?

A. I was.

Q. How did you treat that obligation—as her individual obligation or as one of your marital community? A. One of our marital community.

Q. Showing you Exhibit 20 of the Petitioners, I will ask you whether or not many of the checks had been made out to you.

A. Yes. There are quite a few here made out to me.

Q. Now, Mr. Gustafson, at the time that your wife signed that note in 1943, can you tell the Court

(Testmony of Carl Leonard Gustafson.)

or can you give the Court an idea of your community worth—financial worth with respect to the note of $5,000?

A. You mean what the business was worth, and everything?

Q. Your home and other assets, taking into consideration the net assets over the liabilities?

A. Oh, I suppose I would say about $25,000.

Q. Now, with respect to your engineering education and the formation of this partnership in 1943, will you tell the Court whether or not there was any discussion regarding you re-entering the construction business? [367]

A. Well, there was some small discussion between me and my father-in-law along that line, but that never materialized into anything.

Mr. Potts: Your witness.

Cross-Examination

By Mr. Payne:

Q. Mr. Gustafson, you said that you treated the note which your wife signed as a marital community obligation. Is that right? A. Yes, sir.

Q. Will you explain that?

A. Well, by that I would mean that if that note had to be paid, and she could not pay it, I would be ready to back her up on it.

Q. Well, you haven't treated it at all, did you?

A. I don't understand you.

Q. You said that you treated it as a marital obligation. You haven't treated it yet, however, as

(Testmony of Carl Leonard Gustafson.)

far as the note is concerned, have you? You never have had to pay it, have you?

A. No, but if payment was demanded, I would pay it.

Q. Has it ever been paid?

A. No, it has not.

Q. You know your wife had a rather substantial stated partnership profit on that, didn't you—in 1943, and later? [368] A. That is right.

Q. Why didn't you pay the note out of that? Do you know?

A. I suppose because we were never asked to.

Q. Now, Mr. Gustafson, you have been in business quite a long time, haven't you?

A. That is right.

Q. You know about the obligations of filing income tax returns, don't you? A. Yes.

Q. Who prepared your returns for 1943—your return for 1943?

A. You mean for my business—for my personal business?

Q. Yes, your income tax return.

A. My personal tax return?

Q. Yes.

A. The accountant for the Western Construction Company.

Q. Why was that?

A. Well, probably that was a more convenient way of doing it.

Q. Who was that accountant, do you know?

(Testmony of Carl Leonard Gustafson.)

A. I cannot remember who it was in 1943 exactly by name, no. [369]

Q. Do you remember who did it later?

A. I know Von Harten did it this year, and last year, I believe.

Q. Did you ever talk to him about your income, whether it belonged to you, or whether it belonged to your wife—I mean the income from Western Construction Company.

A. Did you say did I talk to him about it?

Q. Yes. A. No, I did not.

Q. Did you talk to anyone in the Western Construction office about it?

A. Will you repeat the question?

Q. I say, did you talk to anyone in the Western Construction office about it, Mrs. Potts, or Mr. Potts, or any of the Johnson brothers?

A. No, I cannot remember that I ever did.

Q. How did you decide—we will put it this way, you did take into your income return part of the income from the Western Construction Company, didn't you? A. That is right.

Q. Why did you do that?

A. Well, that is what it was supposed to be.

Q. What do you mean by that, "That is what it was supposed to be"? Whose supposition was it that it belonged there—you, or your wife or someone else? [370] A. We both did.

Q. You both did? A. Yes, sir.

Q. Did you talk it over between you and decide to do that?

(Testmony of Carl Leonard Gustafson.)

A. We knew that that was the right thing to do.

Q. And you had done the same thing in 1944 and 1945, and later? A. That is right.

Q. Then would you go down to the Western Construction office and sign the return down there, or was it sent out to you, or how was it handled?

A. Sometimes it was signed down there, and sometimes it was mailed out to us.

Q. And you furnished to them the information regarding your own business, and they finished the return?

A. My bookkeeper from my own business furnished that information.

Mr. Payne: That is all.

Mr. Potts: That is all.

(Witness excused.)

Mr. Potts: I will call Betty Ellingson.

Whereupon,

BETTY LORRAINE ELLINGSON

called as a witness on behalf of the Petitioners, having been [371] first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Potts:

Q. Will you state your full name?

A. Betty Lorraine Ellingson.

Q. Where do you live, Mrs. Ellingson?

A. 914 15th Avenue, Seattle.

(Testimony of Betty Lorraine Ellingson.)

Q. How long have you lived in Seattle, Washington? A. Nearly 26 years.

Q. How long? A. Nearly 26 years.

Q. And you are the daughter of George Johnson? A. That is right.

Q. When were you and Mr. Ellingson married?

A. April 24, 1943.

Q. That was before you became a partner in the limited partnership of Western Construction Company? A. That is correct.

Q. And what was Mr. Ellingson's occupation at that time?

A. He was in the Marine Corps.

Q. In active service? A. Yes.

Q. Mrs. Ellingson, do you recall the formation of the limited partnership in 1943—in 1943 I am referring to. [372]

A. Yes, I do.

Q. Will you tell the Court—by the way, did you become a partner in this partnership in that year?

A. Yes, I did.

Q. Will you tell the Court the reason you became a partner?

A. Well, of course I had heard from my sister and brother that they were in it in 1942, and I was a wee bit envious when they went into it. I understood that they had taken a risk too, but they had done well in 1942, and I was just a little bit jealous. So in 1943 we talked it over, and Lloyd and Bernice were willing to, if it was all right with myself and my husband, to divide their share so that both

(Testimony of Betty Lorraine Ellingson.)

Rachel and I could then enter into it. And we discussed it between ourselves, and realizing the risk we were taking, and maybe it would not all be a bed of roses, why we were going to try it.

Q. What is your husband's occupation?

A. He is a carpenter.

Q. Did that fact have anything to do with your entrance into the organization?

A. Well, yes, it did. My husband worked for a contractor before he went in the Service, and his specification number in the Service was 050, which is a carpenter in the Marne Corps, and they recommended that when he got of out [373] the Service the best thing for him to do would be to go into the construction line of business. And knowing of this, he was quite interested in getting into something of that sort.

Q. Did you discuss this opportunity or investment with him?

A. Yes, we talked it over—we talked it over quite a bit before he finally did something about it.

Q. Now, Mrs. Ellingson, what was your financial condition—yours and your husband's financial condition at the time that you entered in to this partnership?

A. Well, we were not what you would say wealthy, but we had plenty to take care of the note. He had some money that he had coming to him from his father's estate. He hadn't collected it yet, because he had been in the Service when it was due him, but at any time he could have gone back and

(Testimony of Betty Lorraine Ellingson.)

gotten that money, and that money amounted to better than $2,500. And then besides that, of course I was working at the time that we were married, and I drew an allotment of $50 a month, plus his wages, and I knew before the year was up I was going to have another $30 to add to that.

Q. You mean $30 a month?

A. $30 a month allotment to add to that. And I knew that it could be paid up within two years.

Q. However, on that other $30 a month allotment you might have a little expense too, don't you think? [374]

A. Well, there would be a little expense, but then I mean it would take—if I had to gather everything together, I had quite a few sources to gather it from.

Q. Mrs. Ellingson, have you got anything to show us—anything about this inheritance of your husband at that time?

A. Yes. When my husband came back from spending 14 months overseas, we went back East and he got the money that he had coming to him, and we deposited a large amount of it in the bank. He came back from overseas in July, and, as the account will show on this, on July 24, 1944—he got back in the States on July 2, 1944,—we deposited the $1800, and then a month later—not quite a month later—we deposited another $150.

Q. You are reading from a pass book, it that it?

A. Yes. From a pass book of the National Bank of Commerce of Seattle.

(Testimony of Betty Lorraine Ellingson.)

Q. From the National Bank of Commerce of Seattle? A. Yes, sir.

Q. Did you discuss with your husband this obligation on the note, and with regard to his helping you in the event that it became necessary to pay it?

A. I discussed it with him, and of course he realized, too, that even though we had this, that it would still take about the last bottom cent that we had in the bank to pay it off. So he went to talk at the time to a Marine Corps [375] lawyer by the name of Hatten who had been in the Marine Corps with him, and he consulted him with regard to it. I don't know where Hatten is now, but he was supposed to be a very good lawyer, and he told him at the time that he was definitely obligated for that—that if I didn't pay it he would have to pay it.

Q. With that knowledge did you have your husband's consent to sign this note?

A. Yes, I did.

Q. And you did sign the note?

A. Yes, I did.

Q. Now, when your husband got out of the Marine Corps, Mrs. Ellingson, what did he do?

A. He went to work for the Western Construction Company.

Q. And how long did he work for them?

A. Well, he worked for them until the last part of 1946, I believe it was, when the work slowed down, and then he was lent to Kuney-Johnson until the Western Construction Company maybe got a little more work.

(Testimony of Betty Lorraine Ellingson.)

Q. Is he still working for Kuney-Johnson Company?

A. He is still working for that company, yes, sir.

Mr. Potts: Your witness.

Cross-Examination

By Mr. Payne:

Q. How did you acquire your interest in the partnership, Mrs. Ellingson? Did your father give you some money, or how did you work it out?

A. No, there was no money transaction whatsoever. When my brother and my sister Bernice had the two notes for $10,000—that was $20,000 between them—and when they returned those notes I made a note out and gave it to Dad for $5,000, and the interest was all in the company, and it was changed over to my name instead of Lloyd's or Bernice's.

Q. That was in connection with the 1943 partnership? A. That was in 1943, yes.

Q. You said that you were a little bit jealous of the other children. What did you mean by that?

A. Well, when you see somebody else does well one year, why it makes a person a little bit envious Of course, I realize that it might not be so well the next year.

Q. Did you hear about the results in 1942?

A. Well, I was around enough to find out a little bit that they did—that they made a little bit of money after they got through.

Q. You knew that Bernice and Lloyd each had

(Testimony of Betty Lorraine Ellingson.)

a stated $10,000 investment in the 1942 partnership, didn't you?

A. I knew that they had that but, of course, I didn't know just exactly how much they had made in 1942, although I knew that they had made what I thought was probably enough to [377] be something that I would be a little jealous of.

Q. Did you tell your dad about that?

A. Well, we discussed it with Dad.

Q. Well, I asked him at the time just what it was—why I had not been considered when they opened up. And he said, "Well, you wait until you get to be of age," and he said, "You know, there are a lot of risks in it, and while you can make money, you also cannot make money." That is about what I remember about that conversation. You know, that is not the exact conversation, but that is what it amounted to.

Q. Did you tell him that the other two children in your family, Bernice and Lloyd, had made a substantial amount in 1942?

A. No, I didn't tell him that because I—although I knew that they had done pretty well, I didn't know just what the exact amount was. I still don't know what the exact amount is that they made on their interest.

Q. You have heard the testimony here of the last couple of days, haven't you, on those points?

A. That is right, but the actual figures I cannot tell you right now.

(Testimony of Betty Lorraine Ellingson.)

Q. Are there any other children in your family besides the four of you? [378]

A. I have a younger brother.

Q. How old is he? A. 19.

Q. 19 now? A. Yes, sir.

Q. What did your dad say when you told him that you were a little bit jealous about the other two children?

A. I don't remember. I don't remember much else what he did say, except that if it was all right with Bernice and Lloyd, it was all right with him. He has never been partial to any one of us. He has always treated all of us the same way.

Q. What about Rachel? Did you and Rachel talk it over too?

A. Yes. Well, Rachel and I—Rachel had been consulted in 1942, and of course at that time I was not consulted at all. But Rachel and I naturally, when we got together and got to talking between us children, why we talked it over a little bit. But that was about all. Most of the discussion that went on was between my husband and I because, after all, it was our debt that we had to pay back to dad, and it was not Rachel's debt, or Lloyd's debt, or Bernice's debt, but it was my husband's and mine that had to be paid—it was my husband and I that had to pay that $5,000 back.

Q. Did your father suggest that you talk to Bernice and Lloyd? [379]

A. Well, a lot of that came from my own mind. I have always been a little independent that way. I

(Testimony of Betty Lorraine Ellingson.)

would like to get out and make a little bit for myself if I see the chance.

Q. Well, you did talk to Bernice and Lloyd then, did you?

A. Oh yes, I discussed it a little bit with them—yes.

Q. With what result?

A. They were willing to, if I wanted it, to turn their notes back—get their notes back from Dad—the $10,000 note—and then give him another $5,000 note, and in return I would give Dad a $5,000 note for myself, and the same in the case of Rachel.

Q. When did your husband get back from the Marine Corps, Mrs. Ellingson?

A. In October of 1945.

Q. When did he go in?

A. The last part of 1941.

Q. So he was in the Marine Corps——

A. (Interposing): Four years.

Q. I beg your pardon? A. Four years.

Q. He was in the Marine Corps then from what date in 1941?

A. Well, he enlisted in Minneapolis, and he went from [380] Minneapolis to San Diego.

Q. I mean just generally. When did he go into the Marine Corps?

A. It was in December of 1941.

Q. And he didn't get back until October of 1945?

A. That is right, but he was stationed here at Seattle—at Whidby Island, and Sand Point, and

(Testimony of Betty Lorraine Ellingson.)

he was here most of the time except when he was overseas.

Q. Mrs. Ellingson, your husband was in the Service when your 1943 return was prepared then, wasn't he?

A. My husband was—no—well, the 1943 return was prepared in 1944, of course. Yes, he was.

Q. When the time came for making up the return, were you told what you should do about that?

A. Well, yes, I knew that I had—I filed a return before, and I knew that one had to be filed, and I knew that I would have to put down whatever I earned, but when it came to putting down what I had gotten out of my investment in the company, I could not very well have done that, because it would take me a long time to figure that out, so the office figured that part of it out for me, and I supplied the rest of the information, and that was added.

Q. Who made out your return?

A. It was made out down at the offices of the Western Construction Company. [381]

Q. Did you go down there to sign it?

A. Yes, I did. I think I went down there and I sat down—if I remember right at that particular time I sat down there and stayed there until the return was finished, and filled in any information that I may have forgotten.

Q. And part of that income was placed in your husband's return for 1943?

A. I believe so.

Q. What discussion did you have about that?

(Testimony of Betty Lorraine Ellingson.)

A. My husband and I?

Q. Yes.

A. Well, we had discussed that, of course, before he left, when we were talking about this investment—this investment we were talking about—how it should be divided, and naturall we thought that it should be divided split, the same thing as now, that if he makes money, I fiure half of it is mine; in fact, most of the time I figure it is all mine.

Q. Did you have any discussion about that point in the Western Construction Company offices?

A. No.

Q. Whether you should divide it with your husband or whether you should include it in your return?

A. No. I had no discussion down at the Western Construction Company in regard to that. [382]

Q. You just made it out and split it 50-50 with your husband? A. I think that we did.

Q. In 1943? A. yes.

Q. And the same in 1944 and 1945?

A. As I recall, yes.

Q. Now, Mrs. Ellingson, you knew that it would be to your tax advantage to divide your income on a return with your husband, didn't you?

A. Well, yes, maybe I did. I mean, most people go to a store where they can buy eggs cheapest, and they go to any place where they can get it cheapest, and I didn't think that there was anything against the law regarding doing that.

Q. So you decided that it would be a good idea

(Testimony of Betty Lorraine Ellingson.)

to divide the income with your husband from this partnership?

A. Well, on most everything that we do, I think that it is half and half. I figure that if what I make, half of it is his, then he should pay half of the income tax on it, and anything that he makes, if half of that is mine, I think that I should pay half of the income tax on that.

Mr. Payne: That is all.

Mr. Potts: I will have this marked as Petitioners' Exhibit 21 for identification. [383]

(Document above referred to marked Petitioners' Exhibit 21 for identification.)

Re-Direct Examination

By Mr. Potts:

I will show you Petitioners' Exhibit 21 for identification, and I will ask you to tell the Court what that is.

A. This is a financial statement, I guess.

Q. May I ask you if that is a statement of your investment?

A. That is a statement of my investment and withdrawals.

Q. And the checks supporting the withdrawals?

A. That is right.

Mr. Potts: We offer Petitioners' Exhibit 21 for identification in evidence.

Mr. Payne: No objection.

The Court: It will be received in evidence as Petitioners' Exhibit 21.

(Testimony of Betty Lorraine Ellingson.)

(Document heretofore marked Petitioners' Exhibit 21 for identification, received in evidence.)

PETITIONER'S EXHIBIT No. 21

Betty Lorraine Ellingson

June 30, 1943, to Dec. 31, 1945.

Investment		$ 5,000.00
12/31/43	6 mos. net profit	5,788.62
12/31/44	Share net profit	2,075.25
12/31/45	Share net profit	5,693.74
		$18,557.61
	Withdrawals	
9/14/43	Collector of Internal Revenue	222.54
12/ 9/43	Collector of Internal Revenue	222.64
4/13/44	Collector of Internal Revenue	350.00
5/15/44	Collector of Internal Revenue	409.64
5/15/44	Collector of Internal Revenue	354.25
5/15/44	Collector of Internal Revenue	3.54
6/13/44	Collector of Internal Revenue	350.00
9/13/44	Collector of Internal Revenue	350.00
12/11/46	Personal withdrawal	200.00
		$ 2,462.61
Brought forward		$18,557.61
12/31/46	Share of net profit	21.16
		$18,578.77
Withdrawals brought forward		$ 2,462.61
1/14/46	Collector of Internal Revenue	314.66
3/14/46	Collector of Internal Revenue	210.69
3/14/46	Personal withdrawal	63.35
		$ 3,051.31

Admitted May 25, 1948.

(Testimony of Betty Lorraine Ellingson.)

Mr. Potts: I think you have a copy, Mr. Payne, have you not?

Mr. Payne: Yes.

Mr. Potts: That is all. [384]

Re-Cross Examination

By Mr. Payne:

Q. Do you know what those withdrawals were used for, Mrs. Ellingson?

A. Well, yes. Most of them were used for income tax. As long as the income tax was paid down there, this came out of my personal account, and I could not see what difference it made, and our account is savings and not checking, and this is a good way of keeping receipts. Some of them—there are a couple of personal withdrawals here that I took for our own personal use.

Q. How much is the profit shown on that return as having been received with respect to your share from the Western Construction Company for 1945?

A. For 1945?

Q. Yes. A. $5,693.74.

Q. I show you a document which purports to be your individual income tax return for 1945 and ask you if that is your return for that year.

A. Yes.

Q. Can you turn to the information there showing the amount of income received from the Western Construction Company, and state how much is

(Testimony of Betty Lorraine Ellingson.)

reported in that return from that source for [385] 1945.

A. $5,811.90.

Q. There is a slight difference between the two amounts, but I will ask you if you did not include the entire amount in your return for 1945.

A. Yes, I did.

Q. Why? A. I am sorry.

Q. Can you explain that?

A. No, at the time—of course I was working down in California and my husband was down there too, and I recall now some discussion we had between us, but I don't remember just what it was.

Q. You cannot say then?

A. No. I don't recall for certain just what it was—why it was filed separately that year.

Mr. Payne: That is all.

Mr. Potts: That is all.

(Witness excused.)

Whereupon,

EVELYN LILLIAN JORGENS

called as a witness for and on behalf of the Petitioners, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Potts: [386]

Q. What is your name, and where do you reside, Mrs. Jorgens?

(Testimony of Evelyn Lillian Jorgens.)

A. My name is Evelyn Lillian Jorgens, and I live at North 603 Walnut Road, Opportunity, Washington.

Q. Near what city is Opportunity, Washington?

A. It is a suburb of Spokane.

Q. Mrs. Jorgens, you are the daughter of J. A. Johnson, aren't you?

A. That is right.

Q. How long have you resided in the State of Washington? A. For 32 years.

Q. When were you and Mr. Jorgens married?

A. In July of 1939.

Q. What is Mr. Jorgens' occupation?

A. He is a pressman for the Cowles Publishing Company in Spokane.

Q. Mrs. Jorgens, before you were married, what kind of work did you do, if any?

A. I worked in the office in the summertime. Of course I was going to school up until a year before I was married, and I did some work at the Frederick and Nelson Tea Room and the Betty Jarvis Tea Room.

Q. Did you ever work for the Western Construction Company?

A. Yes, just about every summer during high school and [387] college.

Q. Just in the summertime is that? You just worked in the summertime for the Western Construction Company?

A. I believe so. And then a year after I was married I came home and worked in the office for

(Testimony of Evelyn Lillian Jorgens.)

close to a month while Mrs. Potts was in the East.

Q. Now, Mrs. Jorgens, with reference to the formation of the limited partnership of the Western Construction Company in 1942, did you become a member of the partnership at that time?

A. Yes, I did.

Q. How did you acquire your interest?

A. My father gave me the money.

Q. Did he give you the money?

A. He gave me the money, which I turned back to the Western Construction Company and gave him a note for that amount.

Q. You borrowed the money on a note, is that right? A. Yes, sir.

Q. I think that that note is in evidence. Now, at that time, Mrs. Jorgens—at the time that you signed this note in 1942, did you discuss this matter with your husband? A. Yes, I did.

Q. And what was your financial worth at that time—you and your husband's worth? [388]

A. Well, my husband had a good job, and we had just finished building our home, which a year later we turned down $12,000 for. And then we had a new car. We had another lot out in the Valley there near our home. And we had some lake property. We had an investment in an airplane in Spokane, and he had an amateur radio station.

Q. Have you any idea what your community's net assets over liabilities amount to at that time?

A. I don't know the exact figures, but I know that it well covered that note.

(Testimony of Evelyn Lillian Jorgens.)

Q. More than $6,666? A. Yes, sir.

Q. When you signed this note did you have your husband's permission to sign the note?

A. Oh, yes.

Q. What about the community assuming that obligation? Was there any understanding regarding that?

A. Yes, we talked it over between us and we realized that it was just as much his responsibility as mine.

Q. And after that did you—how after that did you divide the income?

A. You mean the income——

Q. (Interposing): Or your returns—the profits from the business. How did you report them?

A. As I understand it—as I remember it I think that [389] we divided the profits.

Mr. Potts: I will have this marked for identification.

(Document above referred to marked Petitioners' Exhibit 22 for identification.)

Q. (By Mr. Potts): Do you know, with reference to Mr. Jorgens, whether there was anything in the conversations leading to your going into this partnership relative to his assuming an active interest in the Western Construction Company?

A. Well, he had been approached on the subject by both my Uncle Albin, and by my father. They didn't think that he should stay over there in Spokane. They thought that he could do better coming

(Testimony of Evelyn Lillian Jorgens.)

over here and going into the carpentry trade and working in the company.

Q. Showing you Petitioners' Exhibit 22 marked for identification, can you tell the Court what that is?

A. This is the record of my investment in the company, and my share of the net profits and my withdrawals.

Q. Now, will you look through this and give to the Court the withdrawals that were not used to pay income taxes.

A. Well, in 1943—February of 1943 we withdrew $3,000 for private use. In April of 1943 we withdrew $1,500. In June of 1943 we withdrew $1,000. In August, on August 12, 1943 we withdrew $1,000. And on March 1st of 1945 we withdrew [390] $2,000.

Mr. Potts: We offer, if the Court please, Petitioners' Exhibit 22 in evidence.

Mr. Payne: No objection.

The Court: It will be received as Petitioners' Exhibit No. 22.

(Document previously marked as Petitioners' Exhibit No. 22 for identification, received in evidence.)

(Testimony of Evelyn Lillian Jorgens.)

PETITIONER'S EXHIBIT No. 22

Evelyn Jorgens

Jan. 1, 1946, to Dec. 31, 1947.

Investment amount brought forward		$60,433.99
12/31/1946	Share of net profit	28.22
		$60,462.21
Withdrawals brought forward		$20,339.99
1/14/1946		286.35
3/13/1946	Collector of Internal Revenue	100.00
		$20,726.34

Evelyn Jorgens

Jan. 1, 1942, to Dec. 31, 1945.

Capital investment		$ 6,666.67
12/31/1942	Share of profits	23,743.94
6/30/1943	6 mos. profit	11,946.55
12/31/1943	6 mos. profit	7,718.17
12/31/1944	Share of profits	2,767.00
12/31/1945	Share of profits	7,591.66
		$60,433.99

Withdrawals

2/..../1943	Cash withdrawn for private investment		$ 3,000.00
3/13/1943	Income tax payment	$1,676.23	
	Cash for private use	1,323.77	3,000.00
4/21/1943	Cash for personal use		1,500.00
6/17/1943	Income tax $1,676.23		1,700.00
	Cash for personal use		1,000.00
8/12/1943	Cash for personal use		1,000.00
9/13/1943	Income tax		1,676.23
12/ 9/1943	Income tax, $1,676.23		1,700.00
4/10/1944	Income tax		600.00
5/15/1944	Collector of Internal Revenue		327.97

(Testimony of Evelyn Lillian Jorgens.)

Withdrawals

5/15/1944	Collector of Internal Revenue	3.28
	Collector of Internal Revenue	329.22
	Collector of Internal Revenue	3.29
6/13/1944	Collector of Internal Revenue	600.00
9/13/1944	Collector of Internal Revenue	600.00
12/16/1944	Collector of Internal Revenue	600.00
3/12/1945		700.00
3/ 1/1945	Cash for personal use	2,000.00
		$20,339.99

Admitted May 25, 1948.

Mr. Potts: Your witness. Just a minute. I neglected to ask Mrs. Jorgens a question.

Q. (By Mr. Potts): Do you recall a contract of the Western Construction Company near Spokane, called the Vee Lox job—a job I believe building the Naval Depot over there? A. Yes, I do.

Q. Will you tell the Court whether or not you assisted the Western Construction Company in any way during the building of that project.

A. Well, I could not go out on the job and work in the office, because I had two young children, but I did assist my father at home with quite a bit of stenographic work in the evenings and on Sundays.

Q. Did you get any payment for that work?

A. No, I did not. [391]

Mr. Potts: Your witness.

(Testimony of Evelyn Lillian Jorgens.)

Cross-Examination

By Mr. Payne:

Q. You testified, Mrs. Jorgens, that your father gave you the money to put back into the Western Construction Company. A. Yes.

Q. Did he give it to you with the understanding that you would put it back in? A. Yes.

Q. And you did as he told you?

A. I did as I wanted to do, but that was——

Q. (Interposing): You mean that you wanted to get the money and wanted to put it back in?

A. We had discussed the idea of this, and when he gave me the money, that was all settled.

Q. You testified that you considered the matter of signing the note, and so forth, before you signed it? A. Yes, we did.

Q. Did anyone tell you if you signed the note alone that the community property of yourself and your husband would not be subject to that obligation? A. No.

Q. No one told you that? A. No. [392]

Q. You testified about the withdrawals. Do you know what the major part of those withdrawals were used for, Mrs. Jorgens?

A. Yes. We started a chicken ranch, and we used that money for the building, for the equipment and for the chickens and the feed.

Q. And there are large amounts in there used for income tax too, is that right? A. Yes, sir.

Q. How did you go about withdrawing the money

(Testimony of Evelyn Lillian Jorgens.)

that you needed for the chicken ranch? Did you ask your father about that?

A. We talked over the idea of going into the chicken business and he said that the money was ours; that we could do with it as we pleased.

Q. How did you go about getting it?

A. I just wrote the office and asked them if they would send me a check for the amount that I wanted.

Q. Did you talk to your father about it?

A. Not each time I withdrew money. We talked to him about starting in the chicken business before.

Q. Do you know where your returns and your husband's returns were made up for 1943, 1944 and 1945?

A. I believe they were made up in Seattle.

Q. You mean in the office of the Western Construction [393] Company? A. Yes.

Q. Why was that done?

A. Well, we prepared at home all the facts regarding our chicken business and his income from other sources over there, and we didn't know what the figures were on this. So we just sent that in to Seattle and the returns were made out here.

Q. Then would they send the returns back over to you for signature?

A. Sometimes, and I think there was a time or two when I sent a signed blank over to them.

Q. When you did what?

A. When I signed the blank first and sent it in to them.

(Testimony of Evelyn Lillian Jorgens.)

Q. And it was completed at the Western Construction Company?

A. Just that one part of it. The rest was already on it.

Q. Mrs. Jorgens, I call your attention to Petitioners' Exhibit 22. I notice that this one check, for example, February 9, 1943, was made to Stanley E. Jorgens.

A. Yes. Stanley S. Jorgens is my husband. Is that Mr. or Mrs.? I see that that is Mr.

Q. And I show you the endorsement on that check and [394] ask you if that is your husband's signature. A. Yes, it is.

Q. You didn't sign that, did you?

A. No, I did not.

Q. What did that represent?

A. That was the first $3,000 that we withdrew to put into the chicken business.

Q. Why was the check made out to him instead of to you?

A. Well, this was community property, and it was just as much his as mine.

Q. You mean that you assumed that it was community property?

A. Well, it is in the State of Washington.

Q. Did somebody tell you that?

A. Well, I knew that before.

Q. How did you find that out?

A. Because all the money that he got from his wages were as much mine as it was his.

Q. Did you ever study law?

(Testimony of Evelyn Lillian Jorgens.)

A. No, I did not.

Q. Then how did you find that out? Did somebody tell you that—your brothers or your father?

A. I don't know when I learned that. I have known that as long as I have known a lot of things. I mean, I didn't learn it at that time. I knew that long before I was [395] married.

Q. Now, I will ask you if the interest was in your name—the interest was in your name in the partnership, wasn't it? A. Yes, sir.

Q. Do you know why the check was made to your husband instead of to you?

A. Because he withdrew the money—that particular amount.

Q. I show you another check dated April 21, 1943, for $1,500 to Stanley Jorgens. I will ask you if you can explain the reason why he withdrew that.

A. May I look in here? (Indicating documents.)

Q. Yes. You may look at all of those exhibits.

A. Was that April 21, 1943?

Q. Yes.

A. Well, that was another one that we withdrew for the chicken business, and he wrote and asked for it as far as I can tell from this.

Q. And another one on April 10, 1944, for $600 to Stanley Jorgens.

A. That was for income tax.

Q. Yours or his?

A. I imagine it was his if it has got his name on it.

(Testimony of Evelyn Lillian Jorgens.)

Q. Another one on March 1, 1945, for $2,000, Stanley [396] Jorgens.

A. Well, that was another one that we withdrew for personal use.

Q. You cannot account for the reason that they made those checks out to him instead of you?

A. Well, I don't think it made any difference. This belonged to both of us, and the chicken business belonged to both of us, and that is what we used it for.

Q. Did you ever give your father or the partnership any notes with respect to those withdrawals?

A. To these withdrawals?

Q. Yes.

A. No, because this was my money.

Mr. Payne: That is all.

Mr. Potts: That is all.

(Witness excused.)

Mr. Potts: I will call Mrs. Bernice Wallin.

Whereupon,

MRS. BERNICE CATHERINE WALLIN

called as a witness for and on behalf of the Petitioners, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Potts:

Q. Will you state your name? [397]

A. Bernice Catherine Wallin.

(Testimony of Mrs. Bernice Catherine Wallin.)

Q. And where do you live?

A. 7214 Lake Ridge Drive, Seattle.

Q. How long have you resided in Seattle, Washington? A. 30 years.

Q. I take it that that is your age?

A. Yes, sir.

Q. You are George Johnson's daughter, are you?

A. Yes, sir.

Q. When were you and Mr. Wallin married?

A. In November of 1938.

Q. Referring, Mrs. Wallin, to the first limited partnership created in 1942, will you tell the Court how you became a limited partner?

A. Well, my father approached me on the matter, and it sounded like a good idea to me. I talked to my husband about it, and he was also—he also thought it was a good investment, so we borrowed $10,000 from my father and invested it in the Western Construction Company.

Q. What evidence, if any, of that indebtedness did you give to your father?

A. We gave him a note.

Q. Mrs. Wallin, what about yours and Mr. Wallin's financial worth at that time?

A. Well, just offhand—— [398]

Q. (Interposing): At the time that you signed the note?

A. Offhand I would imagine that we were worth—oh, around $11,000 or $12,000.

Q. I think yesterday your father testified that

(Testimony of Mrs. Bernice Catherine Wallin.)

you had built a home. Is that correct—at that time, I mean.

A. Well, we were just going to build a home at that time. It was not yet completed.

Q. What was your husband's occupation at that time?

A. At that time he was the manager of a Safeway Store at Renton, Washington.

Q. Can you give the Court an idea about what his annual earnings were?

A. Well, he made approximately $6,000 and $7,000 a year. He was paid a salary, and then he got a bonus of whatever profit his store showed.

The Court: A bonus of a part of the profit.

The Witness: That is right.

Q. (By Mr. Potts): Now, Mrs. Wallin, directing your attention to the next formation of a limited partnership in the following year, will you tell the Court whether there was any change in your interest in that partnership?

A. Yes, there was. Our notes were given back to us and our loan was decreased from $10,000 to $5,000.

Q. You have heard Mrs. Ellingson's testimony here on [399] the stand relative to—Mrs. Ellingson is your sister, isn't she? A. Yes, she is.

Q. You have heard her testimony relative to her getting her interest in the company? A. Yes.

Q. Was her testimony substantially correct with respect to her getting her interest in the company?

A. Yes, that is the way it worked.

(Testimony of Mrs. Bernice Catherine Wallin.)

Mr. Potts: I will have this marked for identification.

(Document above referred to marked Petitioners' Exhibit 23 for identification.)

Q. (By Mr. Potts): Showing you, Mrs. Wallin, Petitioners' Exhibit 23 marked for identification, can you tell the Court what that instrument is?

A. This shows our original investment in 1942 of $10,000 and my share of the net profit and my withdrawals.

Q. Now, Mrs. Wallin, would you look through the withdrawals and give the amount of any, if any, to the Court, excluding payments of income tax or withdrawals for the purpose of paying income tax.

A. The first one was $800.

Q. Can you give the date approximately on that? [400]

A. March 13, 1943. And the second one was May 25, 1945. And that amount was $180. The third amount was—the third was 9-24-45, and that was for $1,826. Then the next one was March 25, 1946, $158.44. And the next one was April 27, 1946, $5,000.

Q. Do you know what the withdrawal of $5,000 was used for?

A. Well, my husband was going into a real estate business, so we withdrew the $5,000 to pay part of it.

Mr. Potts: We offer Petitioners' Exhibit 23.

Mr. Payne: No objection.

The Court: It will be received in evidence as Petitioners' Exhibit No. 23.

(Testimony of Mrs. Bernice Catherine Wallin.)

(Document above referred to, previously marked Petitioners' Exhibit 23 for identification, received in evidence.)

PETITIONER'S EXHIBIT No. 23

Bernice Wallin

Jan. 1, 1942, to Dec. 31, 1945.

5/12/42	Investment	$10,000.00
12/31/42	Share of net profit	35,615.92
6/30/43	6 mos. profit	17,919.80
6/30/43	Reduction in investment	—5,000.00
12/31/43	6 mos. net profit	5,788.62
12/31/44	Share of net profit	2,075.25
12/31/45	Share of net profit	5,693.74
		$72,093.33

Withdrawals

3/13/43	Withdrawals (Income tax $3,200.00, personal $800.00)	$ 4,000.00
6/14/43		3,200.00
9/13/43		3,200.00
12/15/43		3,200.00
4/10/44		350.00
5/15/44	Collector of Internal Revenue	782.27
5/15/44	Collector of Internal Revenue	7.82
5/15/44	Collector of Internal Revenue	384.09
5/15/44	Collector of Internal Revenue	3.84
6/13/44		600.00
9/13/44		350.00
1/11/45		350.00
3/13/45		1,000.00
5/25/45	Personal withdrawal	180.00
9/24/45	Personal withdrawal	1,826.00
		$19,434.02
Brought forward		$72,093.33
12/31/46	Share net profit	21.16
		$72,114.49

(Testimony of Mrs. Bernice Catherine Wallin.)

Withdrawals brought forward		$19,434.02
6/14/46	Collector of Internal Revenue	444.00
3/25/46	Personal withdrawal	158.44
4/27/46	Personal withdrawal for personal investment in real estate business	5,000.00
		$25,036.46

Admitted May 25, 1948.

Q. (By Mr. Potts): Now, Mrs. Wallin, before you signed the note did you have any discussion with your husband about entering the partnership and signing the note? A. Oh yes, certainly.

Q. And was it agreeable to him?

A. Yes, it was.

Q. How was the business venture with respect to the marital community? Was there any arrangement between yourself [401] and your husband as to whether it would be your separate property, or the property and obligation of the marital community?

A. Well, it was just understood that half of anything that he has is mine, and half of anything that I have is his.

Q. Did you so regard this particular venture?

A. Yes, sir.

Q. Now, in the event that this venture had not been successful as it turned out to be, and the note would have to be paid, and there would be no profits, did your husband understand that situation?

A. Yes, he did.

Q. Was he agreeable to assuming his 50 per cent of that risk? A. Yes, he was.

(Testimony of Mrs. Bernice Catherine Wallin.)

Q. Mrs. Wallin, your mother was Amanda Johnson, was she not? A. Yes, sir.

Q. Did you have an interest in her estate?

A. Yes. She died in 1921.

Q. Was your interest in it ever distributed to you? A. No, it has not been.

Mr. Potts: Your witness.

Cross-Examination

By Mr. Payne: [402]

Q. You testified that your husband understood that if this venture was not successful, that the note would have to be paid, is that right?

A. Yes, sir.

Q. Did he understand whether you would have to pay it or whether he would have to pay it?

A. Well, whatever he has is mine, and whatever I have is his, and anything that he made, part of it would be my money, and anything that I made, part of it would be his money.

Q. How did you decide that?

A. When we got married we always understood that.

Q. By reason of your marriage relationship?

A. Yes, that is right.

Q. Nothing further than that?

A. Well, there is a law in the State of Washington that it is a community property state.

Q. You just mean then that you understood the community laws of the State of Washington were applicable, is that right?

(Testimony of Mrs. Bernice Catherine Wallin.)

A. Yes, that is right.

Q. Do you know of your own knowledge whether a note signed by the wife is an obligation of the community property or an obligation of the husband in Washington?

A. I know that if I sign a note and cannot meet it, that he would have to meet it. [403]

Q. How did you find that out?

A. I just have always known that.

Q. Have you? A. Yes, sir.

Q. How long? as I have understood how——

Q. (Interposing): You tell me how long.

A. Oh, I am sure that I cannot remember how long it has been.

Q. Now, I notice, Mrs. Wallin, that some of these withdrawals were made by your husband, Glen Wallin, $4,000, on March 13, 1943, reading from Exhibit 23. Can you explain that?

A. Well, it didn't matter much whom they were made out to.

Q. What was that amount used for, do you know? A. The $4,000?

Q. Yes.

A. Well, $3,200 of it went for taxes—income taxes— and the other $800 was for our own personal use.

Q. Was the $3,200 for income taxes yours or his?

A. It was for both of our income taxes.

Q. I see. You testify that part of it was personal, and the rest of it was payment of the income taxes? A. Yes, sir. [404]

(Testimony of Mrs. Bernice Catherine Wallin.)

Q. Of yourself and your husband?

A. Yes, sir.

Q. Is that right? A. Yes, that is right.

Q. I notice that some other checks were made out to your husband also, $3,200 on September 13, 1943. Is that also income tax?

A. Yes, that is right.

Q. And there is another one on December 15, 1943, to Glen Wallin. A. That is right.

Q. And several other checks also to him. In fact, most of them are to him, aren't they?

A. Well, it didn't make much difference, did it?

Q. Well, I don't know. I am just asking if there was some reason for it. Some to you and some to him. How did you determine who would withdraw the money?

A. Well, whoever was so inclined to withdraw the money, withdrew the money.

Q. Where were your income tax returns prepared, and those of your husband, do you know?

A. Well, we collected all of our data from my husband's business, or he had his account prepared, and it was sent down to the Western Construction Company's office, and we felt there that it was gone over and it was compiled, and [405] they also employed a competent accountant that finally compiled them completely.

Q. And you told them to divide your income between you and your husband for income tax purposes? A. Yes, that is right.

Mr. Payne: That is all.

(Testimony of Mrs. Bernice Catherine Wallin.)

Redirect Examination

By Mr. Potts:

Q. Mrs. Wallin, with respect to your husband, was there anything said in any of the conversations with your father or with any of the other general partners relative to Mr. Wallin taking any active part in the Western Construction Company?

A. Well, that was one of the reasons why my husband went into the real estate business. He had always been interested in real estate, and they were hoping that they would be able to build houses—our city has increased so terrifically—and there has not been adequate housing for all the people and so they had planned, and I was planning, I believe, too—they have some property which they want to build private houses on, and he would handle the real estate.

Q. He would handle the real estate part of the matter, is that it? A. Yes, that is right.

Mr. Potts: That is all. [406]

Recross-Examination

By Mr. Payne:

Q. You never worked for the partnership, did you, Mrs. Wallin?

A. Well, no, I did not. In 1942 when I became a limited partner, I had the opportunity of adopting a baby girl, so I was quite busy at home taking care of her.

(Testimony of Mrs. Bernice Catherine Wallin.)

Q. Your father never expected you to work for the partnership, did he?

A. I would have if I had been needed.

Q. But he never asked you to, did he?

A. He didn't ask me, and he would have asked me if I had been needed.

Q. Did your husband ever work for the partnership?

A. No, he has not, but he expects to.

Q. You testified that you understood that you had an interest in your mother's estate, is that right?

A. That is right.

Q. You do not have any idea what that interest was valued at, do you?

A. I have never asked.

Q. It is still not settled in Court, is that right?

A. No, it is not settled yet.

Mr. Payne: That is all.

Mr. Potts: That is all.

(Witness excused.) [407]

Mr. Potts: I will call Glen Wallin.

Whereupon,

GLEN WALLIN

called as a witness for and on behalf of the Petitioners, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Potts:

Q. Will you state your name, please, and your address, Mr. Wallin?

A. My name is Glen Wallin, and I reside at 7214 Lake Ridge Drive, Seattle.

Q. And you are the husband of the witness that just preceded you on the stand?

A. Yes, sir.

Q. Mr. Wallin, when were you married to Bernice Johnson? A. On November 5, 1938.

Q. With respect to her interest, or to the interest in the Western Construction Company, a limited partnership formed in 1942, were you consulted about that matter? A. Yes, I was.

Q. With whom did you talk about it?

A. With my wife, Bernice.

Q. And what was the outcome of your conversations with [408] her with respect to the interest that she was to have or signing a note for the interest in the partnership?

A. Well, they asked her, or she wanted to put this investment in the company, and $10,000 was a lot of money, and I knew that if Bernice would put that interest in the company and sign a note for it, I would also be responsible. And whether it is a lot or

(Testimony of Glen Wallin.)

not, I don't know, but I would still be responsible. That was my understanding.

Q. Was that your understanding?

A. That was my understanding.

Q. During the formation of this partnership was there anything discussed with you about the possibility of your becoming actively engaged in the partnership?

A. Well, I had been discussing any interest that I could serve the partnership for a long time, but I had one job—the only job that I ever had in my life—and I was with one company for a long, long time, so I didn't see yet where I could possibly serve the company.

Q. With respect to the date that Mrs. Wallin signed this note, in 1942, can you give the Court any idea of your net financial worth—the net financial worth of yourself and your wife, disregarding her sole and separate estate. Just taking into consideration your community estate, can you give the Court any idea of your net financial worth?

A. Well, that was about the time—well, we were [409] contemplating building a house, so we had our money saved up for that. We had probably in cash—we figured we had around $12,000.

Mr. Potts: Your witness.

Cross-Examination

By Mr. Payne:

Q. You say it was your understanding that if your wife signed a note, that you would be responsible on it? A. Yes, sir.

(Testimony of Glen Wallin.)

Q. Who told you that?

A. Well, I have always considered it the law in this state—that it is a community property law—but whether or not it is the law, I would be responsible anyway, and I told her that I would.

Q. You told her that you would be responsible for it out of your separate estate or out of your community property? A. Yes, either way.

Q. You testified that there was some discussion about the possibility of you going into business with the Johnsons. Isn't it true that they had discussed that with all of their sons and sons-in-law in your presence at various times?

A. Well, I had a set-too with them. For two or three hours I talked with my father-in-law and also Albin. What we wanted to do—well, the way business is now, it has become so highly specialized that it takes a good education and [410] initiative to run a business. Now, I am not a college graduate, and I am not an engineer, and I cannot serve the company in that respect, but we figured by going into the real estate business, and we wanted to develop some huge private housing programs, like those of Carroll Hedlund and Hillman, that I would be in a good position to handle those deals for the company.

Q. When did you go into the real estate business?

A. In 1946.

Q. This interest to your wife was not given to her with the understanding that you were to go into the partnership, was it?

A. What do you mean?

(Testimony of Glen Wallin.)

Q. Well, you know about your wife obtaining an interest in this partnership back in 1942, don't you?

A. Oh, yes. You mean the one that she bought in?

Q. Yes. A. Yes.

Q. There was not any understanding that you were to go with the partnership in connection with that interest that she acquired. A. No.

Mr. Payne: That is all.

Mr. Potts: By the way, are you trained in insurance too? [411]

The Witness: Yes, I am.

Mr. Potts: That is all. Thank you.

(Witness excused.)

Mr. Potts: Mr. George Johnson, will you take the stand again?

Whereupon,

GEORGE JOHNSON

previously called as a witness for and on behalf of the Petitioners, having been previously duly sworn, was recalled and testified as follows:

Direct Examination

By Mr. Potts:

Q. Mr. Johnson, I have recalled you for the matter that we reserved yesterday regarding these notes.

(Handing document to witness.)

The Court: Have they already been marked?

(Testimony of George Johnson.)

Mr. Potts: No. We reserved this yesterday. So these will be 24.

The Court: These are the first two notes?

Mr. Potts: Yes, Your Honor.

The Court: They will be marked for identification as Petitioners' Exhibit 24.

(Documents above referred to marked Petitioners' Exhibit 24 for identification.)

Mr. Potts: One of these is the original [412] that Mr. Lloyd Johnson had, and we have no photostat copy.

The Court: You do not have a photostat copy?

Mr. Potts: No, so we are introducing the original, with the consent of Counsel. We will just offer that.

Mr. Payne: No objection.

The Court: They will be received in evidence as Petitioners' Exhibit 24.

(Document above referred to, previously marked Petitioners' Exhibit 24 for identification, received in evidence.)

Mr. Potts: I will have this marked Petitioners' Exhibit 25.

(Documents above referred to marked Petitioners' Exhibit 25 for identification.)

Mr. Potts: Which are the four $5,000 notes.

The Court: Yes.

Mr. Potts: We offer those in evidence.

(Testimony of George Johnson.)

Mr. Payne: No objection.

The Court: They will be received as Petitioners' Exhibit No. 25.

(Documents above referred to previously marked Petitioners' Exhibit 25 for identification, received in evidence.)

Mr. Potts: I guess I do not need to ask you any more questions, Mr. Johnson. [413]

Mr. Payne: Now that we have got him there, I guess I had better ask him some, but I think I had better wait until my case comes on.

Mr. Potts: I will give you permisson to do so.

Mr. Payne: It would not be proper cross-examination at this time, so I will wait until we put our case on.

(Witness excused.)

The Court: We will recess for ten minutes.

(Recess)

Mr. Potts: I will call Mrs. Potts.

Whereupon,

MRS. LUCILLE EASTERBROOK POTTS called as a witness for and on behalf of the Petitioners, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Potts:

Q. What is your name?

A. Lucille Easterbrook Potts.

Q. You are my wife, are you?

A. That is right.

Q. And associate Counsel?

A. That is right.

Q. Mrs. Potts, when were you married? [414]

A. 1939.

Q. Prior to that time for whom had you been employed—by whom had you been employed?

A. By the Western Construction Company.

Q. When were you first employed by the Western Construction Company? A. In 1932.

Q. In 1932? A. Yes.

Q. And since 1939 have you been employed by the Western Construction Company?

A. Yes.

Q. Up to what date?

A. Oh, I worked—I still help them out once in a while but I have not really worked for several years—that is done actual work five days a week, or anything like that.

Q. Directing your attention to the formation of

(Testimony of Mrs. Lucille Easterbrook Potts.)

the limited partnership in 1942, were you in the office of the Western Construction Company at that time? A. Yes, I was.

Q. With respect to the condition of the partners at that time, I think Counsel would like to know the financial status of the partners as of the date of the formation of the limited partnership. Can you give that to us?

A. Well, Albin Johnson had—you mean before the [415] partnership was formed?

Q. Yes, immediately before.

A. He had $44,465.16.

Q. Albin had how much? A. $44,465.16.

Q. Now, what about the other two?

A. George Johnson had $92,034.28.

Q. What about J. A.?

A. He had $97,535.58.

Q. Now, how was the capital account of the general partners carried in the formation of the limited partnership in 1942?

A. Then they set up an amount of $15,000, which, incidentally, was supposed to have been $20,000, but it was set up wrong. They set up $15,000.

Q. For whom?

A. For each of the three general partners.

Q. Now, you say that that should have been $20,000. Was it ever corrected?

A. It was corrected in June of 1943.

Q. With the filing of the next certificate?

A. That is right.

(Testimony of Mrs. Lucille Easterbrook Potts.)

Q. And how was it set up then?

A. $20,000 in each of their accounts.

Q. Then what was the limited partners' [416] account?

A. They were all set up on the books.

Q. Well, I was thinking of the amount. Let us take each family. What was the limited partners' account?

A. Each family had $20,000. And it was divided sometimes two, three or four ways.

Q. Regardless of the number of limited partners that were admitted from any one of the three families, the total limited partners' interest in that family was $20,000, is that right?

A. That is right.

Q. And that equaled the general partners' interest? A. That is right.

Q. So that in 1943 the general partners' interest was $60,000, and the total of the limited partners' interest was also $60,000? A. That is right.

Q. But in 1942 the general partners' interest totaled $45,000? A. Yes.

Q. And the total limited partners' interest was $60,000? A. That is right.

Q. Now, when were the first profits entered upon the books of the company after the formation of the first limited partnership? [417]

A. After the books were closed, December 31, 1942.

Q. And were there any withdrawals by any limited partner prior to that?

(Testimony of Mrs. Lucille Easterbrook Potts.)

A. Prior to the end of 1942?

Q. Yes.

A. No. They didn't have anything to withdraw.

Q. Now, after that, in 1943, was there an earning? A. Yes, there was.

Q. For the limited partners? A. Yes.

Q. Now, who kept the books in 1943?

A. I did.

Q. Will you tell the Court whether there was any restriction of any kind upon any of the limited partners withdrawing——

A. (Interposing): No.

Q. (Continuing): any part of the whole of their earnings on their investment? A. No.

Q. Was there ever any restriction?

A. No, there was not. I took care of everybody's account.

Q. With the formation of the limited partnership in 1942, and again in 1943, were there any meetings of the limited partners held? [418]

A. No, there were not.

Q. Any minutes of any meetings, or of any committees, or boards of any kind kept? A. No.

Q. Any seal maintained? A. No.

Q. Any officers elected? A. No.

Q. Who conducted the business of the limited partnership?

A. George Johnson, J. A. Johnson and Albin Johnson.

Q. Now, will you tell the Court, with respect to

(Testimony of Mrs. Lucille Easterbrook Potts.)

the activities of Lloyd, Roy and Winston Johnson, after the formation of the limited partnerships, and both of them, what the activities of those three in the limited partnerships were?

A. Well, of course Roy worked for the company —are you asking for any particular year? I am sorry.

Q. After the formation of the first limited partnership, and again after the formation of the second, what were the activities of Lloyd, Roy and Winston with respect to the Western Construction Company?

Mr. Payne: Your Honor, that is a rather complexed question. I think if we are going into that we ought to break that down and get down to dates and individuals.

Q. (By Mr. Potts): Well, [419] let us take the year 1942 after the formation of the limited partnership.

A. Well, of course Lloyd was with Kuney-Johnson. He used to be down to the office a lot of the time. I used to call him up a lot of the time. In fact, I used to get embarrassed because I had to call him so much, and I had to ask him about this, that, and the other thing.

Mr. Payne: You are talking about Lloyd?

The Witness: Yes. Well, he was—he was down around there a lot of the time.

Q. (By Mr. Potts): Well, being down and around there a lot of the time, I am not so concerned with that. Will you tell the Court whether he did

(Testimony of Mrs. Lucille Easterbrook Potts.)

anything to further the business of the partnership in 1942.

A. Would you want specific things that he did?

Q. Yes. Anything that you recall, that he was required to do.

A. Well, he came down and helped to price jobs. He helped us to take stock as I recall. He helped us to get materials sometimes. I called him several times myself about getting material.

Q. Well, now, what about Roy in 1942?

A. Roy did more or less the same thing. I do not think that he was there quite as much as Lloyd. I don't remember now. [420]

Q. What about Winston?

A. Well, of course Winston was there all the time after the formation of the partnership, to date, practically.

Q. What kind of work did Winston do there? I am referring to the office—that part of the work that you saw.

A. He was in the office a great deal of the time. And he was out to the projects a great deal of the time. He was out getting materials a lot of the time. He let a lot of the sub-contracts. He wrote a lot of letters. He did a lot of dictating work on the letters in the office. And he went to a lot of conferences with the Navy and the Army, and so forth.

Now, let us see what else he did. In fact, he did everything. If anybody wanted him to go out and do some figuring—well, if anyone wanted him to do it, he even figured a payroll, and everything.

(Testimony of Mrs. Lucille Easterbrook Potts.)

Q. Now, with respect to 1943 what did Lloyd do, if anything to further the business?

A. I think the years—I mean, it was more or less continuous. They did the same thing in 1943 that they did in 1942.

Q. Well, would that be true of Roy?

A. Well, I guess Roy started to work in 1943—to work there all the time.

Q. What about Winston? [421]

A. Winston was there in 1943 doing the same thing, getting sub-contracts and materials, and estimating, and going out to the projects. He was out to the project part of the time, too.

Q. Going back a little, you were there during the time of Coulee Dam, were you not—during what has been testified to here as the Coulee Dam job?

A. That is right.

Q. Will you tell the Court what the financial experience of the three partners—the three older men—was on the construction of the Coulee Dam bridge piers?

A. They lost a lot of money. We didn't have any cash. There might have been some assets that were not liquid, but they didn't have any money at all, and they owed just lots and lots of bills.

Q. You heard the testimony here about the three older brothers trying to get some outside capital. Do you know anything of their quest in that regard of your own knowledge?

A. The only thing I know—they had told me that they had gone to see Philip Johnson of the

(Testimony of Mrs. Lucille Easterbrook Potts.)

Boeing Aircraft Company, and I was there when he came into the office, and I was there when he talked to them. And I heard him say that he was not interested in making an investment with them.

Q. Now, with respect to the formation of the corporation, will you tell the Court about [422] that.

A. Well, after Coulee Dam we formed a corporation—of course they were very anxious to get some more contracts to straighten the mess out that they were in. And they went down to the bank, and the bank told them that they would loan them $10,000, but they had to form a corporation, and the bank wanted them to put it in Lloyd's and my name. So the bank loaned us the $10,000, and we started the corporation, and it was Lloyd, Roy and I who had the stock.

Q. Now, did you three continue to hold that stock all the way through until the dissolution?

A. No.

Q. Tell the Court what happened to the stock?

A. Well, for one thing after I got married in 1939 I didn't want to really work anymore, and the war came along, and so I quit. And the corporation was a lot of trouble. I had to go up to Roslyn and down to Tacoma to sign papers, and all this and that, and I just didn't want to do it anymore, so I suggested that I wanted to turn my stock in, and at that time I think we transferred all of the stock.

Q. That is, Roy and Lloyd did it too?

A. Yes.

(Testimony of Mrs. Lucille Easterbrook Potts.)

Q. What was the financial condition of the partnership at that time?

A. I don't remember exactly—just exactly. I don't know the exact date that we did transfer the stock. [423]

Q. At any rate their condition improved——

A. (Interposing): Oh, yes.

Q. (Continuing): when the stock was turned back?

A. Oh, yes. Then it was all right. The bank had no objections to their having the stock.

Q. Now, showing you Respondent's Exhibit C, or the articles of co-partnership that has been testified to were executed by the three older brothers and their three sons, can you tell the Court anything about the reason for the execution of those articles

A. Well, it was to form a partnership among the six of them.

Q. Well, what was the reason that the three sons were brought in?

A. They wanted their three sons in the company very, very badly.

Q. After this agreement or these articles were signed, was that set up on your books? Did they go ahead upon the basis of those articles?

A. No, they did not.

Q. Do you know why they did not?

A. I really don't. It was just dropped.

Q. Did the fact that Lloyd Johnson had made a successful venture with Mr. Kuney have anything

(Testimony of Mrs. Lucille Easterbrook Potts.)

to do with the failure to go ahead on those [424] articles?

A. I don't remember right now. I have not seen them for a long time.

Q. Well, directing your attention as to the formation of the limited partnership, can you tell the Court the reason for the formation of that—those reasons that are of your own personal knowledge?

A. The reason that they formed——

Q. (Interposing): The reason that they formed the limited partnership?

A. The reason that they formed the limited partnership?

Q. Yes.

A. Well, there were a lot of reasons. In the first place, the construction game was not the same as it was when the Johnsons started in business. At the time that they started in business many of the companies here were carpenters who worked up to be contractors, but now it is more specialized. They needed their sons in the business. They needed that technical training. It is not the same as it was when they started in business. They have been very successful, and I do not think that there are any better contractors in the world, but business is different today than it was 25 years ago. I think that they needed their sons and sons-in-law in the business.

Q. Well, did they realize it? Did they show the realization of that fact—the three older brothers themselves? [425]

A. Well, certainly they realized it.

(Testimony of Mrs. Lucille Easterbrook Potts.)

Q. Now, was there any financial reason for the formation of the limited partnership?

A. Yes, that brought more money into the company. That was just about the beginning of the war contracts. They needed the additional capital to get bonds to carry on the work.

Q. Now, the question has been asked different witnesses by Counsel regarding the preparation of income tax returns for the limited partners. Will you explain that to the Court?

A. The preparation?

Q. The preparation of the income tax returns in the office of the Western Construction Company for the limited partners.

A. Oh, yes. Most of them were prepared in the office of the Western Construction Company. We never got our books closed at the end of the year. We always were just beating the deadline, so we used to send out—we used to make up questionnaires and send them out to the limited partners, asking them to send in all their information because we would be late again this year and we told them to send in all the information because we were always right on the deadline. It is always such a job getting the books closed at the end of the year, and everything. [426]

Q. Some of the checks in evidence on these different limited partners have been made out to the husbands of the limited partners. Was there any reason for that?

A. No. If the husband was the one who came in

(Testimony of Mrs. Lucille Easterbrook Potts.)

to get the check, the check was made out to the husband, and if the wife came in to get the check, it was made out to the wife, or whoever came in after it—it was made out in their name.

Q. Are there some of the limited partners' returns that are not yet in evidence?

A. Here are some.

Mr. Potts: I should like to introduce these. First of all I will have this one of Elsie Keil Mathewson marked for identification.

The Court: That will be marked as Petitioners' Exhibit 26 for identification.

(Documents above referred to marked Petitioners' Exhibit 26 for identification.)

Mr. Potts: We offer that in evidence.

Mr. Payne: We won't object to this.

The Court: Very well. It will be received as Petitioners' Exhibit No. 26 in evidence.

(Documents previously marked Petitioners' Exhibit 26 for identification received in evidence.)

PETITIONER'S EXHIBIT No. 26

Elsie Kiel Mathison

Jan. 1, 1942, to Dec. 31, 1945.

5/ 7/1942	Investment	$10,000.00
12/31/1942	Share of net profits	35,615.92
6/30/1943	Share of profits, 6 mos.	17,919.80
6/30/1943	Reduction of Investment	—3,333.33
12/31/1943	Net profits to 12/30/43	7,718.17
12/31/1944	Share of net profit	2,767.00
12/31/1945	Share of net profit	7,591.66
		$78,279.22

(Testimony of Mrs. Lucille Easterbrook Potts.)

Withdrawals

3/15/43	Collector of Internal Revenue	$ 3,211.54
6/15/43	Collector of Internal Revenue	1,628.52
6/15/43	Collector of Internal Revenue	1,583.01
9/14/43	Collector of Internal Revenue	1,499.37
9/14/43	Collector of Internal Revenue	1,499.37
October	Personal withdrawal	129.15
12/15/43	Collector of Internal Revenue	1,489.36
12/15/43	Collector of Internal Revenue	1,628.52
4/13/44	Collector of Internal Revenue	600.00
5/15/44	Collector of Internal Revenue	591.11
5/15/44	Collector of Internal Revenue	5.91
5/15/44	Collector of Internal Revenue	412.03
5/15/44	Collector of Internal Revenue	4.12
6/13/44	Collector of Internal Revenue	600.00
9/13/44	Collector of Internal Revenue	600.00
9/28/44	Personal withdrawal	100.00
11/10/44	Personal withdrawal	200.00
12/13/44	Personal withdrawal	200.00
3/13/45	Collector of Internal Revenue	575.74
3/13/45	Collector of Internal Revenue	577.52
3/23/45	Personal withdrawal	880.00
5/ 4/45	Dr. Harold Burkhart	284.00
12/21/45	Personal withdrawal	200.00
		$18,499.27

Brought forward		$78,279.22
12/31/46	Share of net profits	28.22
		$78,307.44
Withdrawals brought forward		$18,499.27
1/14/46	Collector of Internal Revenue	1,359.73
5/14/46	Personal withdrawal	300.00
6/18/46	Personal withdrawal	7,000.00
12/20/46	Personal withdrawal	500.00
3/14/46	Personal withdrawal	45,976.52
9/ 5/46	Personal withdrawal	1,000.00
		$74,635.52

Admitted May 25, 1948.

Mr. Potts: And I will have this one of Mrs. Vedola [427] Johnson Kent marked for identification as Petitioners' Exhibit 27.

(Testimony of Mrs. Lucille Easterbrook Potts.)

(Document above referred to marked Petitioners' Exhibit 27 for identification.)

Mr. Potts: We offer Petitioners' Exhibit 27 in evidence.

Mr. Payne: We have no objection.

The Court: Very well. It will be received in evidence as Petitioners' Exhibit 27.

(Document previously marked Petitioners' Exhibit 27 for identification was received in evidence.)

PETITIONER'S EXHIBIT No. 27

Vedala Johnson Kent

June 30, 1943, to Dec. 31, 1945.

6/30/1943	Investment	$ 6,666.66
12/31/1943	6 mos. net profit	7,718.18
12/31/1944	Share net profit	2,767.00
12/31/1945	Share net profit	7,591.66
		$24,743.50

Withdrawals

9/14/43	Collector of Internal Revenue	$ 315.80
12/ 9/....	Collector of Internal Revenue	315.80
3/ 9/44	Personal withdrawal	250.00
4/13/44	Collector of Internal Revenue	600.00
5/16/44	Collector of Internal Revenue	1,459.69
6/13/44	Collector of Internal Revenue	600.00
5/16/44	Collector of Internal Revenue	14.69
9/13/44	Collector of Internal Revenue	600.00
9/27/44	Personal withdrawal	70.00
11/16/44	Personal withdrawal	200.00
1/10/45	Personal withdrawal	75.00
3/23/45	Personal withdrawal	400.00
8/25/45	Personal withdrawal (Jesse Sumrall)	52.00
12/21/45		200.00
		$ 5,152.89

(Testimony of Mrs. Lucille Easterbrook Potts.)

Brought forward		$24,743.50
12/31/46	Share of net profit	28.22
		$24,771.72

Withdrawals Forward

1/14/46	Collector of Internal Revenue	$ 236.82
3/14/46	Collector of Internal Revenue	276.45
5/14/46	Personal withdrawal	300.00
6/18/46	Personal withdrawal	7,000.00
12/20/46	Personal withdrawal	500.00
12/31/46	Standard Service Tire	47.40
3/14/47	Personal withdrawal	6,586.25
		$20,099.91

Admitted May 25, 1948.

Mr. Potts: And I will have this one of Eleanor Rector marked as Petitioners' Exhibit 28 for identification.

(Document above referred to marked Petitioners' Exhibit 28 for identification.)

Mr. Potts: We will offer Petitioners' Exhibit 28 in evidence.

Mr. Payne: We have no objection.

The Court: It will be received as Petitioners' Exhibit No. 28.

(Document previously marked for identification as Petitioners' Exhibit 28 for identification, received in evidence.)

(Testimony of Mrs. Lucille Easterbrook Potts.)

PETITIONER'S EXHIBIT No. 28

Eleanor Rector

Jan. 1, 1942, to Dec. 31, 1945.

5/28/1942	Investment	$ 6,666.67
12/31/1942	Share of profits, 1942	23,743.94
6/30/1943	Share of profits, 6 mos.	11,946.55
12/31/1943	Share of profits, 6 mos.	7,718.18
12/31/1944	Share of profits, 1944	2,767.00
12/31/1945	Share of profits, 1945	7,591.66
		$60,434.00

Withdrawals

3/13/1943		$ 5,000.00
3/10/1944		2,000.00
4/ 6/1944		600.00
5/16/1944		7,300.00
6/13/1944		600.00
1/ 3/1944		600.00
1/10/1945		600.00
3/ 9/1945		750.00
		$17,450.00

Eleanor Rector

Jan. 1, 1946, to Dec. 31, 1947.

Balance forwarded		$60,434.00
12/31/1946	Share of net profit	28.22
		$60,462.22
Withdrawals forwarded		$17,450.00
2/20/1946		2,325.74
8/18/1947		10,000.00
		$29,775.74

Admitted May 25, 1948.

Q. (By Mr. Potts): Showing you Eleanor Rector's statement, would you read to the Court the withdrawals that were not used to pay income taxes?

A. I really don't know what was used to pay

(Testimony of Mrs. Lucille Easterbrook Potts.)

income tax. These checks are all made directly to Dr. Rector. They are as follows:

March 13, 1943, $5,000;
March 10, 1944, $2,000;
April 6, 1944, $600;
April 16, 1944, $7,300;
July 13, 1944, $600;
January 10, 1945, $600;
March 9, 1945, $750;
February 20, 1946, $2,325.74;
April 18, 1947, $10,000.

Q. Making what sum in total withdrawals?

A. $29,775.74.

Q. There has been some testimony here that Roy Johnson had overdrawn his account in the sum of $6,600, and he testified that he sent a check back in that amount. Will you tell the Court about that transaction?

A. Well, he drew out his capital, and he was up in Alaska, and I wrote him a note and told him to send back a check for $6,600 to get his capital back in, and he sent the check. [429]

Q. Did anyone direct you to do that?

A. Nobody else would have known. I was the only one who knew right then about it, so I wrote to him and told him to send it back.

Q. Would you let me look at that record of Roy Johnson—is that it? (Indicating.)

A. Yes.

Q. Now, would you tell the Court whether or not before you received the check for $6,600 there

(Testimony of Lucille Easterbrook Potts.)

was a credit to Mr. Roy Johnson's account which would have alleviated the necessity of his returning that check?

A. Oh, yes. When we closed the books—it happened in this way, we closed the books at the end of 1945, or when we were closing the books, then I discovered that he had overdrawn. The profit for that year had not been distributed. I didn't know what it was because it took quite a while to figure out the depreciation, and this and that, and the other thing, so I wrote to him to send it back right away, and he did—no, he didn't send it back right away. And then we got our profits distributed, and he got his profits on the books, and it would have been all right then.

Q. It was some time after you had written him before you got the check with the return?

A. We hardly ever got the books closed for the year before March 1st—actually closed, and everything. [430]

Mr. Potts: Your witness.

Cross-Examination

By Mr. Payne:

Q. You have before you, Mrs. Potts, Exhibit 28 admitted in evidence on behalf of the Petitioners, which I understand is the statement of the investment and the withdrawals of Mrs. Eleanor Rector. A. Yes, sir.

Q. Do you know how she received her investment in the limited partnership?

(Testimony of Lucille Easterbrook Potts.)

A. How she received her investment?

Q. Yes. Did she receive it the same as the others?

A. Yes, she received it the same as the others.

Q. In fact, all of the children involved in these two limited partnerships are in the same circumstances so far as the acquisition of their interest is concerned. A. That is right.

Q. Have you examined the copies of the income tax returns of Mrs. Rector?

A. No. I intended to do so this noon, but I really haven't had time to look them over.

Q. You do not know what part of her withdrawals were necessary to pay her federal taxes, do you?

A. No, I really do not, until I go over it a little.

Q. Are you familiar with the notes which have been the [431] subject of testimony here, Mrs. Potts? A. Yes.

Q. I show you Petitioners' Exhibit 24, which is the note given by Lloyd Johnson to his father, which is marked, "Paid, 6-30"—I will revise that. That is the note given by Lloyd on April 21, 1942, is it not? (Showing document to witness.)

A. Yes.

Q. With respect to the first partnership?

A. Yes.

Q. And it is marked, "Paid, 6-30-42."

A. 6-30-43.

Q. I stand corrected. Now, what does that mean?

(Testimony of Lucille Easterbrook Potts.)

A. Well, that is my writing, where I wrote, "Paid, 6-30-43."

Q. And how was that paid?

A. This when he gave the new note, and naturally then he wanted this one back.

Q. But he didn't pay any cash?

A. No, he didn't pay any cash, and he wanted this note back, and I didn't want it laying around, so I just marked it that way.

Q. Do you know whether any of these notes were paid during 1945?

A. Yes, they were. [432]

Q. Do you know which ones were paid—how many?

A. Well, they were paid to their fathers. I think Lloyd has paid his note.

Q. Well, are you testifying from memory now, or from records? Do you happen to know?

A. I would not have any records.

Q. You would not?

A. They paid their notes to their fathers.

Q. All you know about that is what they told you?

A. It would probably be what they told me, and what I have heard and seen.

Q. In other words, if and when they paid them, they paid them to the individuals and not through the partnership? A. Yes, that is right.

Q. Do I understand that a good many were not paid in 1945?

A. I think some of them were and some of them were not. I know some of them were paid and

(Testimony of Lucille Easterbrook Potts.)

some of them were not.

Q. Now, Mrs. Potts, you testified first about the formation of the corporation? A. Yes.

Q. And the taking of the stock in your name and in the names of Lloyd and Roy? A. Yes.

Q. When did you say that that stock was given back— [433] what year?

A. It must have been—it was either before or after I was married, and I was married in June of 1939. It was probably afterwards. It was 1939 or 1940 probably—maybe it might have been six months one way or the other.

Q. And the stock was given back to whom?

A. To J. A. Johnson, George Johnson and Albin Johnson.

Q. In fact, each of you transferred all of your stock to those three individuals, is that right?

A. That is right.

Q. Mrs. Potts, you gave some testimony about this Exhibit C, which is before you, the articles of copartnership executed January 6, 1941?

A. Yes.

Q. Were you instructed to set up books of accounts with respect to that partnership?

A. No. If I had been so instructed, I am sure that I would have done so.

Q. What was the partnership doing at that time —do you recall? A. In 1941?

Q. Yes. Where were they engaged at that time?

A. In 1941 they had the Bremerton job—January of 1941.

(Testimony of Lucille Easterbrook Potts.)

Q. That was substantial work over there, wasn't it? [434]

A. They had just barely started. I think they started around the middle of December, 1940.

Q. And carried on through 1941?

A. Until about the end.

Q. And finished at the end of 1941 some time?

A. I think that that is about the date.

Q. How do you account for the fact that nothing was ever set up on the books with respect to this partnership—if you know?

A. It has never been set up on the books, or anything.

Q. Has any distribution been made to the boys with respect to that partnership? A. No.

The Court: I have not understood—let me see if I get it right. I do not know what bearing it would have in this case, but I have not understood anybody to contend that that partnership was effected. Am I right about that?

Mr. Potts: That is right.

Mr. Payne: We want it in the record, to show the different attempts and the different tries which were made here with respect to family partnership.

The Court: My understanding of that partnership is, and I have so understood it throughout the hearing, that it was never effected. Is that right?

Mr. Potts: That is right, Your Honor. [435]

The Court: So naturally she did not set anything up on the books about it because the parties

(Testimony of Lucille Easterbrook Potts.)

themselves did not regard it as an operating partnership.

Q. (By Mr. Payne): Mrs. Potts, when the first limited partnership was formed, in February of 1942, did you set up books on that?

A. Yes, I did.

Q. Did you set them up immediately?

A. Yes, I think so.

Q. How about the one in 1943? Did you set those books up immediately? A. Yes.

Q. You gave your understanding of the reasons why the limited partnerships were formed. You said one was to bring the sons into the business; is that right? A. Yes.

Q. But that partnership provided for them coming in as limited partners, did it not?

A. Yes.

Q. Now, you stated also that it was to bring in more money into the company, is that right?

A. That is right.

Q. Did it do that, in your opinion?

A. I think it did.

Q. How? Will you please show us from the books how [436] that brought in new capital into the Western Construction Company?

A. Well, there is $60,000 in money that the limited partners have put in.

Q. I beg your pardon?

A. There is $60,000 in the amount that the limited partners have put in.

(Testimony of Lucille Easterbrook Potts.)

Q. Well, will you show the Court that on the records of the partnership?

A. Do you want me to show him each account?

Q. Yes, there are not too many.

A. All right. Winston Johnson, $10,000 and——

Q. (Interposing): Just a minute. Let us take Winston Johnson. Where did that $10,000 come from according to your books?

A. Well, without regard to the books I know where it came from. He borrowed it from his father. The books do not show that.

Q. Well, what do the books show with respect to that $10,000?

A. The books show $10,000 deposited in the bank to the credit of the Western Construction Company.

Q. Did that come out of Albin Johnson's capital account?

A. Yes, I know that it did. I know that they borrowed [437] the money from Albin Johnson. But it does not show on the books.

Q. Well, what I am getting at is, how was there an increase in the partnership investment?

A. Well, the money was deposited in the bank account.

Q. You just testified that the notes were given to their fathers individually; that the fathers held the notes, and you would not have any knowledge as to when or how those notes were paid.

A. I do know of my own knowledge that some of them were paid. I know that.

Q. But you said that they were not paid through the partnership records or accounts.

(Testimony of Mrs. Lucille Easterbrook Potts.)

A. No. I mean, they were not notes of the partnership. They were notes to George Johnson, Albin Johnson and J. A. Johnson, and when they paid them, they paid them to them.

Q. What was the partnership investment—the aggregate partnership investment just before the formation of the first limited partnership, according to the books?

A. Well, it was those three figures I gave you before, added together, of the Johnsons.

Q. The three figures that you gave us on direct examination? A. Yes.

Q. Now, can you tell me whether that figure would be [438] increased or decreased when the new partnership was formed—that aggregate figure? A. Well, there was still $60,000 more.

The Court: It seems to me that you are getting into the field of argument now. As I understand it, the new limited partnership that was evidenced by a written agreement, starts out with $60,000 capital of the general partners and $60,000 of the limited partners.

Mr. Payne: That is the second partnership, Your Honor. The first partnership was $45,000.

The Court: Well, it was, as I understand it, corrected. The witness has testified that it really meant a $60,000 capital and that later, even before the second partnership was entered into you had put on your books $60,000. Is that right?

The Witness: No. I think that the entries were all made at the same time.

(Testimony of Mrs. Lucille Easterbrook Potts.)

The Court: At the second partnership?

The Witness: Yes.

The Court: Then, as I understand it, the books show $15,000 each for the general partners, and $60,000 for the limited partners on that first partnership. And then the second partnership, as I understand it, was $60,000 for the general partners and $60,000 for the limited partners.

The Witness: That is right. [439]

The Court: And as to whether those were additional assets, well, that is a matter for argument. As I understand it the general partners have said that they had notes that were added to their assets, and they, themselves, were liable for the entire indebtedness of the partnership, and that being true, they had additional assets which would be subject to their debts. I do not want to restrict the examination, but I do not think that we will particularly get anywhere by arguing it.

Mr. Payne: I will try to avoid arguing with the witness about that.

The Court: Very well.

Q. (By Mr. Payne): Let me ask you this question, Mrs. Potts, turning to the account of Winston Johnson that you made mention of a moment ago——

A. (Interposing): That is the one I happened to open first.

Q. You show there a $10,000 credit on what date? A. May 7, 1942.

(Testimony of Mrs. Lucille Easterbrook Potts.)

Q. And did that much cash come into the partnership? A. Yes, it did.

Q. Where?

A. It was deposited in the bank. We have the deposit slip showing where it was deposited. [440]

Q. Do you know where the money came from?

A. He borrowed it from his father.

Q. Did the money come out of the partnership that went for that?

A. His father used the money out of the partnership.

Q. Will you turn to the records and show us the withdrawal of that money that went to Winston for that $10,000.

A. Yes. His father drew out $20,000. I presume it was the same $20,000.

Q. What date was that?

A. April 21, 1942.

Q. And then it came back immediately, following that, in the respective accounts of the children of Albin, is that right?

A. That is right. We deposited the $10,000 that Winston gave us, and the $10,000 that Elsie Keil gave us.

Q. And is that true of each of the other families? The checks went out from the father in each case to his children immediately before the deposit was made back in the name of the children?

A. Certainly. They loaned the children the money.

Q. The checks were drawn on the partnership

(Testimony of Lucille Easterbrook Potts.)

account, and the deposit came back into the partnership account? A. Yes, sir.

Q. Did you receive instructions from anyone, Mrs. Potts, [441] with respect to paying checks to the husbands of the girls who were members of the limited partnership?

A. Well, no—no, I don't think so.

Q. You just did that on your own responsibility?

A. I think they probably knew. I think everybody knew what I was doing. I wrote all the checks. I paid the personal bills and everything else of all the Johnsons without asking.

Q. Mrs. Potts, I show you a document which is marked as Respondent's Exhibit B, the partnership return for 1942. That is the first limited partnership. I call your attention to the schedule. You are familiar with this return, aren't you?

A. I didn't make it out. I don't make out income tax returns.

Q. Well, I call your attention to the schedule attached to that return, showing contracts completed from which profits were received in that year.

A. Yes.

Q. Will your books show when the Coast Guard job was begun?

A. Not these books here—no.

Q. Do you know when it was begun?

A. Oh, heavens, no, I don't remember.

Q. Do you remember when the cold storage job was begun? [442]

(Testimony of Lucille Easterbrook Potts.)

A. I remember the jobs, but I do not remember when they were started or finished.

Q. Do you have the books in the Courtroom that show that?

A. No, I do not. After the jobs are finished, the records are transferred to old files.

Q. Who would know when those contracts were entered into?

A. Well, we could look it up. We do not have that information here right now.

Q. You do not know which one of the general partners would know about that?

A. No, I do not.

Q. Mrs. Potts, after the limited partnership in 1942 was formed did you carry two accounts on the partnership books? A. Yes, we did.

Q. Now, what were they? Will you explain that, please?

A. You mean of the general partners?

Q. Well, did you carry one account for the limited partnership itself?

A. May I have that question again?

Q. As I understand it, the first limited partnership, it had a stated capital of $105,000; is that correct? A. That is right. [443]

Q. Did you set that up in one account on the books? A. No.

Q. Now, I will ask you this, after you set up the $105,000 stated capital to the members of that limited partnership, plus the accounts to the general partners, was there an amount, or a credit still to the account of the general partners?

(Testimony of Lucille Easterbrook Potts.)

A. Yes, there was.

Q. And you set that off in a separate sheet on your books? A. Oh, yes.

Q. So that——

A. Interposing): Or some bookeeper did. I didn't do it.

Q. And was that money, or is it your understanding that money was still used in the business the same as before?

A. Yes, and they used it to draw against, too, all the time.

Q. And it was used in connection with the continuation of the partnership business?

A. And for their drawings.

Q. Do your records show what their borrowings were in 1942 and 1943—the amount of the borrowed money?

A. I am sorry, I do not have that book here. Those sheets were transferred. I did not know that you wanted them. [444]

Q. You do not remember of your own knowledge what the borrowings were?

A. No, but if I am not mistaken, at the time that they formed the limited partnership—at the time that they formed it, they owed the bank about $80,000, if I remember correctly. They owed the bank then that much when the limited partnership was formed.

Q. When we come back in Court tomorrow could you have the information about the borrowings of 1942, 1943, 1944 and 1945?

(Testimony of Lucille Easterbrook Potts.)

A. I do not know if I could have them here by tomorrow morning at 9 o'clock. I will try to have them here by that time.

Q. I thought that you were going to have all these books here.

A. I thought you wanted the current books. I am sorry. Otherwise, I would have had them here.

Q. I would like to have that information tomorrow morning if that information is available.

The Court: I think we will recess until tomorrow morning at 9:30 so that will give her a little more time to get that information.

Mr. Payne: That is all at this time.

Mr. Potts: That is all.

(Witness excused.) [445]

Mr. Potts: At this time I should like to read into the record certain citations from Remington's Revised Statutes of the State of Washington relative to the formation of limited partnerships.

The Court: Well, Mr. Potts, we take judicial notice of that.

Mr. Potts: Well, I will just give you the citations, if Your Honor please.

The Court: You can if you want to.

Mr. Potts: I thought it might be helpful for the records, perhaps.

The Court: I would hardly think so. I am not objecting to it, but in your brief you will probably cite and quote the statutes from Washington.

Mr. Potts: Well, Your Honor takes judicial cognizance of the statutes——

The Court: (Interposing): We do.

Mr. Potts: (Continuing): Why it is not necessary for me to cite them at this time.

The Court: We do. We take judicial knowledge of all State statutes, and we do not have to be proved. Of course if you had a foreign statute, for example, that of Sweden, you would have to prove that. You would have to prove foreign law, but the laws of the States of the United States do not have to be proven. [446]

Mr. Potts: Well then I can shorten the record to that extent.

The Court: I do not think it will be necessary to cite those statutes now because in your brief, I dare say, you will refer to the statutes and quote them, and your brief is where we look at the law, and the record of the evidence is where we look for the facts.

Mr. Potts: Very well.

Mr. Payne: Could I recall Mrs. Potts for one or two questions?

The Court: Yes, you may.

Whereupon,

MRS. LUCILLE EASTERBROOK POTTS

a witness previously called on behalf of the Petitioners, resumed the stand, having been previously sworn, was examined and testified as follows:

Cross-Examination
(Continued)

By Mr. Payne:

Q. Mrs. Potts, you have heard the testimony in this proceeding about the amounts paid to Winston and to Roy Johnson in connection with their services for the partnership? A. Yes.

Q. Can you tell the Court whether or not withholding taxes were taken from the amounts so paid then? A. Yes, they were. [447]

Q. Throughout all the years in which compensation was paid them?

A. As far as I know they were.

Q. The same as in the case of any other employee? A. That is right.

Mr. Payne: That is all.

(Witness excused.)

Mr. Potts: In the morning, if the Court please —we haven't the records here at this time, but in the morning we should like the privilege of introducing or offering certain contracts with the Navy to show the limited partnership with respect to those contracts. That is, how the contract was prepared setting forth the limited partnership.

I believe with that exception the Petitioners now rest their case.

The Court: Very well.

Mr. Payne: If Your Honor please, at this time we should like to offer to the Court an agreed stipulation of certain facts in the proceeding, which has been in process for a time, and I think it verifies some matters for the Court, and it does cover the agreement we have with respect to several of the issues that we made in the opening statement.

The Court: Very well. The stipulation of the parties will be received in evidence in the case.

Mr. Payne: With agreement of Counsel we should [448] like to offer at this time the partnership returns of the Western Construction Company for the remaining years which are before the Court.

The Court: Well, I suggest that you offer them one at a time, Mr. Payne. Begin with Exhibit D.

Mr. Potts: We have no objection.

Mr. Payne: The 1942 return is already in evidence. We offer at this time, Your Honor, the partnership return for 1943.

The Court: It will be received as Respondent's Exhibit D.

(Document above referred to, marked Respondent's Exhibit D, received in evidence.)

Mr. Payne: And the next is the return for 1944.

The Court: It will be received as Respondent's Exhibit E.

(The document above referred to, marked Respondent's Exhibit E, received in evidence.)

Mr. Payne: And the next is the partnership return for 1945.

The Court: It will be received in evidence as Respondent's Exhibit F.

(Document above referred to, marked Respondent's Exhibit F, received in evidence.)

Mr. Payne: If Your Honor please, I would like to [449] show the Court at this time a mimeographed copy of the findings of fact and the opinion of the Court in the previous proceeding involving the individuals there—the general partners of the Western Construction Company—which involved the taxable year 1941. There are in that opinion findings of fact, beginning on Page 3, which are about some general matters pertaining to when Albin Johnson came into the partnership, and their activities, and the results of their activities. And then beginning on Page 8 some further findings of fact about the Western Construction Company, and the activities that they had at Bremerton and the West Park Housing Project with the West Coast Construction Company, and facts relating to that contract, and the borrowings of money, and the result of that contract, and so forth.

We should like to offer that in evidence for the purpose of the findings of fact in that opinion, with the understanding that the facts stated in that opinion are true and correct and may be accepted as fact in this present proceeding. It gives some background that we think is essential, and it will save us some time in going over some of the details contained therein.

Mr. Potts: The Petitioners, Your Honor, have no objection to Counsel introducing the fact as set forth in the opinion. However, I want to call Your Honor's attention that the facts introduced in that case of course are not the [450] facts as all introduced in this case, with some exceptions. Consequently the opinion of the Court is that case—I might read from paragraph 14, or from Page 14, which deals with the community property of Rose and Albin Johnson, and it says. "However, neither Albin's partnership's interests—" I might go a little further. "The knowledge, experience, ability and personal care and attention of the partners were required to develop the rights and produce the income, and on the basis of the evidence we think that these elements were of far greater importance in the production of income than were any property rights or interests. Coming from a married man, these interests constitute a community contribution."

Now, in this case the facts are more fully introduced, and I do not think that the same conclusion can be drawn, and I dislike to have an opinion of the Court introduced into the case.

The Court: The opinion certainly would not be admissible, because there is no res judicata here that I can see at all.

Mr. Payne: No, Your Honor. We are not making any such contention.

The Court: If there are some facts stated in this case which you think would be stated more briefly and to the point, and to prove them, could you not

stipulate those facts and offer them as a stipulation in evidence? [451]

Mr. Potts: I would stipulate that any facts contained in this Court decision—I would agree should be admitted in evidence here.

Mr. Payne: That is all we expected to do, Your Honor. We did not expect the opinion to go in as facts.

The Court: No.

Mr. Payne: But the findings of fact to be accepted as the background of the facts in this proceeding.

The Court: Well, would it not be better rather than for us to have to search them out, we adjourn and let you read that into the record tomorrow—the fact that you want to go into evidence here in this case, and it will save us the task of having to look through this or that?

Mr. Payne: Very well.

Mr. Potts: As far as the Petitioners are concerned, we think that that would be the more satisfactory method of introducing them.

The Court: I would think that it would, just reading them into the record.

Mr. Payne: Considerable evidence was given, as you recall, about the background of this partnership, about the Coulee Dam conditions, and the Erickson relationship or the West Coast relationship with the Western Construction Company. I did not cross-examine regarding those things because I felt that the data which we thought were important [452] about those, the Bremerton Housing

Project and the period involved, and all those things, could be obtained for the record by reading them into the record from this.

The Court: It would short-cut the thing if you would read it into the record.

Mr. Potts: I have no objection to Counsel reading the statement of fact into the record.

The Court: Very well. The reason I would suggest that—well, I would not allow you to read into the record anything that does not have anything to do with this transaction. If it all does, why all right.

Mr. Payne: Well, Your Honor, it would be used as a basis for argument. For example, the contract there was very successful, and there was a very substantial profit made by the partnership in 1941 which, we think, forms the psychological background for the formation of the partnership in 1942, and there is a showing in that record of the borrowed money which was necessary to conduct the business, and so forth.

The Court: Yes.

Mr. Payne: Which is, in our opinion, pertinent background.

The Court: Well, in the morning you can do that. Apparently the Petitioners have no objection to introducing these facts into the record.

Mr. Payne: Well, the facts are rather compact and [453] rather short in that opinion—the findings of fact in that opinion. I think it would be satisfactory just to introduce it alone—just have the findings of fact and not have the opinion, of course.

The Court: Well, if you want to do that, we can just cut out the opinion part and not have it before us at all, and just receive the findings of fact.

Mr. Payne: That is all I intended to offer. In fact, that was the preface to my statment. Those are all fact there, and whichever party wishes to, that party could refer to them as facts in this proceeding.

Mr. Potts: That will begin on Page 3 and end on Page 5?

Mr. Payne: Well, the findings of fact are set out very clearly with proper preface in each case. The findings of fact were supplied in two sections, one beginning on Page 3, and the other, I think, on Page 8.

The Court: Now, let us receive in evidence Pages 3 and 5—where is Page 4 in this? It just says 3 and 5.

Mr. Potts: The lettering may be different there than Counsel's.

Mr. Payne: The copy, Your Honor, that you have is a different mimeographed one than the one which Mr. Potts has, and the pages are apparently different. One is mimeographed on both sides, and the other is not. [454]

The Court: Oh, I see. That is where Page 4 is. All right.

In this case of Albin Johnson and others, as I understand it, Docket numbers are 5856, 5857, 5876, 5877 and 5878, Respondent offers in evidence the findings of fact contained on Pages 3, 4 and 5 in

that case, and you want all the findings of fact on issues 2 and 3——

Mr. Payne (Interposing): Yes, appearing on Page 8 and——

The Court (Interposing): Appearing on Pages 8, 9, 10, 11 and down to the middle of Page 12 received in evidence?

Mr. Payne: That is correct, your Honor.

The Court: And those facts are received in evidence, but it is understood that none of the opinion is before the Court in any way in this case.

Mr. Payne: That is correct, your Honor.

Mr. Potts: That is fine.

The Court: I think it will be well to number that or letter that, rather, as Respondent's Exhibit G, because it is an exhibit. Those pages can be pinned together and offered. The opinion is not offered at all.

(Document above referred to, marked Respondent's Exhibit G, received in evidence.)

Mr. Payne: If your Honor please, there has been testimony on some of these limited partners concerning the [455] amounts withdrawn for purposes of paying their federal taxes. In some cases they are fully identified in the exhibits already in evidence. In other cases so called personal withdrawals were made, and they, in fact, were in payment of federal taxes, which were paid directly by the individuals rather than by the Western Construction Company.

We have obtained from the Collector of Internal Revenue tax statements with respect to the limited partners and their respective spouses, with the ex-

ception of Eleanor Rector and her husband, who live in Ohio, and we have prepared from those statement schedules which show part of the same information which is already in the Petitioners' exhibits as to the withdrawals, but show further the tax payments or the tax application with respect to each limited partner and their spouse, with the exception of Eleanor Rector and her husband, and we should like to offer at this time, your Honor, those schedules as a joint exhibit. I understand that Mr. Potts has no objection.

I might state that the only purpose I am offering them for is to show the actual amounts of the withdrawals which were used for tax payments.

The Court: Well, if you want to offer it as a joint exhibit, it will be received as Joint Exhibit 29-H.

Mr. Potts: Well, I do not know, if the Court please, that I want to join in the introduction of that. [456] However, I have no objection to the exhibit.

The Court: You have no objection to it?

Mr. Potts: No.

The Court: Well, it will be received as Respondent's Exhibit H.

Mr. Payne: Yes.

(Document above referred to, marked Respondent's Exhibit H, received in evidence.)

RESPONDENT'S EXHIBIT H

Comparison of Charges (amounts paid to or on behalf of) to limited partners accounts with income taxes paid to the Collector and interest paid to the general partners.

Limited Partner	Children of
1. Bernice Wallin)	
2. Lloyd W. Johnson)	George J. Johnson
3. Rachel Gustafson)	
4. Betty Lorraine Ellingson)	
5. Roy W. Johnson)	
6. Evelyn Jorgens)	J. A. Johnson
7. Eleanor Rector)	
8. Winston A. Johnson)	
9. Elsie Keil)	Albin Johnson
10. Vedola J. Kent)	

Harold and Betty Ellingson

Date	Charges to Partnership Account	Tax Payments Harold On 1942-1943 Liability		Tax Payments Betty On 1942-1943 Liability		Tax Payments Harold On 1944 Liability		Tax Payments Betty On 1944 Liability		Interest to Father March 1945	Excess of Charges Over Tax Payments
9/14/43	$222.54	9/13/43	$111.27	9/13/43	$111.27						None
12/ 9/43	222.64	12/15/43	111.32	12/15/43	111.32						None
4/31/44	350.00							3/15/44	$350.00		None
4/11/45	1,700.00	4/ 1/45	820.83	4/ 1/45	855.60						23.57
7/30/43	1,000.00										1,000.00
8/12/43	1,000.00										1,000.00
9/13/43	1,676.23	9/15/43	820.73	9/15/43	855.50						None
12/ 9/43	1,700.00	12/15/43	820.93		855.70						23.37
4/10/44	600.00					4/15/44	$300.00	4/15/44	$300.00		None
5/15/44	327.97	5/15/44	327.97								None
5/15/44	3.28		Int. 3.28								None
5/15/44	329.22			5/15/44	329.22						None
5/15/44	3.29				Int. 3.29						None
6/13/44	600.00					6/15/44	300.00	6/15/44	300.00		None
9/13/44	600.00					9/21/44	300.00	9/21/44	300.00		None
12/16/44	600.00					12/19/44	300.00	12/19/44	300.00		None
3/12/45	700.00	3/15/45	346.11	3/15/45	347.37						6.52
3/ 1/45	2,000.00										2,000.00
										$719.42	(719.42
	$20,339.99		$3,960.68		$4,102.28		$1,200.00		$1,200.00	$719.42	$9,157.61

Harold and Betty Ellingson

Date	Charges to Partnership Account	Tax Payments Harold On 1942-1943 Liability		Tax Payments Betty On 1942-1943 Liability		Tax Payments Harold On 1944 Liability		Tax Payments Betty On 1944 Liability		Interest to Father March 1945	Excess of Charges Over Tax Payments
9/14/43	$222.54	9/13/43	$111.27	9/13/43	$111.27						None
12/ 9/43	222.64	12/15/43	111.32	12/15/43	111.32						None
4/31/44	350.00							3/15/44	$350.00		None
5/15/44	409.64	5/15/44	409.64								None
5/15/44	354.25			5/15/44	354.25						None
5/15/44	3.54				Int. 3.54						None
6/13/44	350.00							6/19/44	350.00		None
9/13/44	350.00*										350.00
12/11/45	200.00										200.00
										$300.00	(300.00)
	$2,462.61		$632.23		$580.38				$700.00	$300.00	$250.00

* Partnership Records show Collector as Payee, item not shown in 899.

Roy W. and Elsie A. Johnson

Date	Charges to Partnership Account	Tax Payments Roy W. On 1942-1943 Liability		Tax Payments Elsie A. On 1942-1943 Liability		Tax Payments Roy W. On 1944 Liability		Tax Payments Elsie A. On 1944 Liability		Interest to Father March 1945	Excess of Charges Over Tax Payments
3/13/43	$3,000.00	3/15/43	$979.58	3/15/43	$1,053.75						$966.67
6/15/43	2,050.00	6/26/43	979.58	6/26/43	1,053.75						16.67
9/13/43	2,050.00	9/15/43	715.58	9/15/43	977.80						356.62
12/28/43	2,050.00	12/15/43	715.58	9/15/43	977.80						356.62
4/10/44	600.00					4/15/44	$300.00	4/15/44	$300.00		None
5/15/44	380.92	5/15/44	380.92								None
5/15/44	3.81		Int. 3.81								None
5/15/44	532.13			5/15/44	532.13						None
5/15/44	5.32				Int. 5.32						None
6/13/44	600.00					6/19/44	300.00	6/19/44	300.00		None
9/13/44	600.00					9/22/44	300.00	9/22/44	300.00		None
1/10/45	1,000.00										1,000.00
3/ 1/45	20,000.00										20,000.00
3/13/45	455.61	3/15/45	455.61								None
3/13/45	457.48			3/15/45	457.48						None
6/26/45	10,000.00										10,000.00
7/30/45	9,000.00										9,000.00
										$719.42	(719.42)
	52,785.27		$4,230.66		$5,058.03		$900.00		$900.00	$719.42	$40,977.16

Stanley and Evelyn L. Jorgens

Date	Charges to Partnership Account	Tax Payments Stanley On 1942-1943 Liability		Tax Payments Evelyn On 1942-1943 Liability		Tax Payments Stanley On 1944 Liability		Tax Payments Evelyn On 1944 Liability		Interest to Father March 1945	Excess of Charges Over Tax Payments
2/ ../43	$3,000.00										$3,000.00
3/13/43	3,000.00	3/15/43	$820.83	3/15/43	$855.60						1,323.57
4/31/43	1,500.00										1,500.00
7/17/43	1,700.00	7/ 1/43	820.83	7/ 1/43	855.60						23.57
7/30/43	1,000.00										1,000.00
8/12/43	1,000.00										1,000.00
9/13/43	1,676.23	9/15/43	820.73	9/15/43	855.50						None
12/ 9/43	1,700.00	12/15/43	820.93		855.70						23.37
4/10/44	600.00					4/15/44	$300.00	4/15/44	$300.00		None
5/15/44	327.97	5/15/44	327.97								None
5/15/44	3.28		Int. 3.28								None
5/15/44	329.22			5/15/44	329.22						None
5/15/44	3.29				Int. 3.29						None
6/13/43	600.00					6/15/44	300.00	6/15/44	300.00		None
9/13/44	600.00					9/21/44	300.00	9/21/44	300.00		None
12/16/44	600.00					12/19/44	300.00	12/19/44	300.00		None
3/12/45	700.00	3/15/45	346.11	3/15/45	347.37						6.52
3/ 1/45	2,000.00										2,000.00
										$719.42	(719.42)

Date	Charges to Partnership Account	Tax Payments Winston On 1942-1943 Liability		Joyce B. On 1942-1943 Liability		Tax Payments Winston On 1944 Liability		Joyce B. On 1944 Liability		Interest to Father March 1945	Excess of Charges Over Tax Payments
3/15/43	$4,434.76	3/15/43	$4,434.76								None
6/15/43	4,434.77	7/ 1/43	4,434.77								None
9/13/43	4,434.76	9/15/43	4,434.76								None
10/25/43	275.00										$ 275.00
12/ 9/43	4,434.76	12/12/43	4,434.76								None
1/ 6/44	1,000.00										1,000.00
4/13/44	600.00					4/15/44	$300.00	4/15/44	$300.00		None
5/15/44	1,280.51	5/15/44	1,280.51								None
5/15/44	Int. 12.80		12.80								None
6/14/44	600.00					6/15/44	300.00	6/15/44	300.00		None
6/20/44	508.50										508.50
6/13/44	525.00										525.00
6/12/44	25.00										25.00
9/13/44	600.00					9/29/44	300.00	9/29/44	300.00		None
1/11/45	600.00					1/23/45	300.00	1/23/45	300.00		None
3/12/45	1,672.08	3/15/45	1,672.08								None
3/23/45	880.00										880.00
12/31/45	200.00									$880.00	200.00
	$26,517.94		$20,704.44				$1,200.00		$1,200.00	$880.00	$2,533.50

Rudolph and Elsie Keil [Peneil Notation] Now Mathison.

Date	Charges to Partnership Account	Tax Payments Rudolph On 1942-1943 Liability		Elsie On 1942-1943 Liability		Tax Payments Rudolph On 1944 Liability		Elsie On 1944 Liability		Interest to Father March 1945	Excess of Charges Over Tax Payments
3/15/43	$3,211.54	3/15/43	$1,583.02	3/15/43	$1,628.52						None
3/15/43	1,628.52			7/ 1/43	1,628.52						None
3/15/43	1,583.01	7/ 1/43	1,583.91								$ (.90)
9/14/43	1,499.37			9/15/43	1,499.37						None
10/14/43	1,499.37	9/15/43	1,499.37								None
Correction	129.15			9/15/43	129.15						None
12/15/43	1,489.36	12/15/43	1,489.36								None
12/15/43	1,628.52			12/15/43	1,628.52						None
4/13/44	600.00					4/15/44	$300.00	4/15/44	$300.00		None
5/15/44	591.11	5/15/44	591.11								None
5/15/44	5.91	Int.	5.91								None
5/15/44	412.03			5/15/44	412.03						None
5/15/44	4.12			Int.	4.12						None
6/13/44	600.00					6/19/44	300.00	6/19/44	300.00		None
9/13/44	600.00					9/22/44	300.00	9/22/44	300.00		None
9/28/44	100.00										100.00
11/10/44	200.00										200.00
12/13/44	200.00										200.00
3/13/45	575.74			3/15/45	575.74						None
3/13/45	577.52	3/15/45	577.52								None
3/23/45	880.00										880.00
5/ 4/45	284.00										284.00
12/21/45	200.00										200.00
										$876.65	(876.65)
	$18,499.27		$7,330.20		$7,505.97		$900.00		$900.00	$876.65	$986.45

Warren L. and Vedola Kent

Mr. Potts: With the permission of Counsel, if the Court please, I would like to put Mrs. Potts back on the stand. She has found an error in some of the figures that she has testified to, and she wishes to correct that error.

The Court: Very well.

Whereupon,

MRS. LUCILE EASTERBROOK POTTS

recalled as a witness for and on behalf of the Petitioners, having been previously duly sworn, was further examined and testified as follows:

Direct Examination

By Mr. Potts:

Q. You wish to correct some of your testimony with respect to the partnership accounts immediately previous to the formation of the first limited partnership, is that right?

A. When I read those figures I included some personal real estate of George and J. A. Johnson that had no business [457] in the partnership. So the figures should be as follows:

Albin Johnson, $44,465.16;

George Johnson, $48,803.10;

and J. A. Johnson, $34,231.42, which was their capital as of December 31, 1941.

Mr. Potts: Your witness.

Cross-Examination

By Mr. Payne:

Q. What are you now reading from, Mrs. Potts?

(Testimony of Mrs. Lucile Easterbrook Potts.)

A. An audit report. I have checked it with the books.

Q. What were you reading from before?

A. The books. I had some personal real estate of George Johnson and J. A. Johnson. That was never supposed to have been on the books, and at that time we had taken it off.

Q. How long had it been on the books?

A. Oh, I don't know. It was just carried there for convenience.

Q. When did you first come into the partnership? A. In 1932.

Q. Were they there when you came there?

A. I think so.

Q. So they were on the books there from the time that you came there until 1942, is that right?

A. They carried it on the books, yes, and we set it up in a separate account. [458]

Q. And it was taken off when?

A. At that time, January 1, 1942. It was taken off then.

Q. I thought that the new partnership was not formed until February 24, 1942.

A. I don't know what you mean.

Q. The new partnership—the new limited partnership was not formed until February 24, 1942, isn't that right?

A. Yes. And you wanted the figures as of January 1, 1942?

Q. No, I wanted them as of the date of the formation of the new partnership.

(Testimony of Mrs. Lucile Easterbrook Potts.)

A. Oh, I was not giving you the figures—I was giving them to you as of the end of the year.

Q. I thought you were testifying that you were giving us the figures as of the date before and after the formation of the limited partnership in 1942.

A. They were substantially the same.

Q. I cannot hear you.

A. They were substantially the same, I would imagine.

Q. But the figures that you have just read now are after taking out certain personal assets of J. A. Johnson and George Johnson?

A. Yes, sir, that is right.

Q. Which have been on the partnership books ever since [459] you have had anything to do with them. A. That is right.

Mr. Payne: That is all.

Redirect Examination

By Mr. Potts:

Q. Can you tell us what those assets consist of, which is not used for partnership purposes?

A. Real estate most of it is—a vacant lot.

Q. But I mean, it is not a part of the construction business?

A. Oh no. Most of it is just a vacant lot.

Mr. Potts: That is all.

(Testimony of Mrs. Lucile Easterbrook Potts.)

Recross-Examination

By Mr. Payne:

Q. Were they used, Mrs. Potts, for the purpose of listing assets to the bonding company?

A. They are personal assets.

Q. That which you just testified to, as belonging to George and J. A. Johnson?

A. They always listed all their assets.

Q. In making bank statements of assets for the purpose of giving loans?

A. They always list all of their assets—yes. They would not leave those off.

Q. Now, let me ask you this, were they used for [460] similar purposes after the formation of the limited partnership?

A. Well, they were their own personal assets.

Q. Yes, but I am asking you if they were similarly used for those purposes afterwards.

A. When they furnished their own personal financial statements, they used all their assets—naturally.

Q. So there was no change than except just the way you switched them on the books, was there, after the formation of the limted partnership in 1942?

A. They were their own personal assets in their own personal names.

Q. That is my understanding too. There was no change except the change you made on the books?

A. That is right.

Mr. Payne: That is all.

Mr. Potts: That is all.

(Witness excused.)

Mr. Payne: I understand that the Petitioner has concluded his evidence, Your Honor.

The Court: Yes.

Mr. Payne: We would like to get from Mrs. Potts in the morning if we could the statements showing the borrowed money of the partnership in 1942, 1943, 1944 and 1945, and we have one or possibly two other witnesses, which will take a [461] very short time in the morning. We ought to conclude in a very short while tomorrow.

The Court: Well, we will recess until 9:30 in the morning, and I imagine that we will have no difficulty in concluding the case by noon.

Mr. Payne: We ought to be able to conclude the case in an hour so far as we are concerned. And that well might give us an opportunity to check through our notes and our files.

The Court: That is perfectly satisfactory. We will get through all right. So we will now recess until 9:30 tomorrow morning.

(Whereupon, at 5:20 p.m., a recess was taken until 9:30 a.m., May 26, 1948.) [462]

May 26, 1948

Mr. Potts: If the Court please, I reserved a matter last night regarding two contracts, and instead of having them identified I have shown them to Counsel, and they are just two small matters, and I should like to, without having these marked as exhibits, show them to Mr. George Johnson and ask him about them.

The Court: All right.

Mr. Potts: Mr. Johnson, will you take the stand again?

Whereupon,

GEORGE JOHNSON

recalled as a witness for and on behalf of the Petitioners, having been previously duly sworn, was further examined and testified as follows:

Direct Examination

By Mr. Potts:

Q. Showing you, Mr. Johnson, what purports to be a contract, can you tell the Court if this is a contract for construction—this instrument that I am showing you? Do you identify that?

A. Yes. This is much later, isn't it?

Q. Yes. The date is in 1944. Do you identify the document? A. Yes. [465]

Q. What is that document?

A. Well, this is the building contract for the Naval Air Station up at Whidby Island. We built——

(Testimony of George Johnson.)

Q. (Interposing): Well, who is that contract made with? Who are the contracting parties?

A. Well, the Western Construction Company and the Navy.

Q. All right. Now, when you say, "The Western Construction Company," will you read to His Honor the wording of the document as respects the party who is going to do the work—the contractor.

A. The Western Construction Company, a partnership, consisting of three general partners, J. A. Johnson, George Johnson and Albin Johnson, and ten limited partners.

Q. All right. And the date of this contract, please. A. The 21st day of August, 1944.

Q. All right. Now, showing you another document, will you tell the Court what that document is?

A. Well, this is a contract between the Bureau of Yards and Docks, Navy Department, and the Western Construction Company.

Q. Now, will you read to the Court the designation of the Western Construction Company as set forth in that document?

A. J. A. Johnson; George Johnson and Albin Johnson, [466] as general partners, and the ten limited partners.

Q. And the date of that contract?

A. This is the 14th day of September, 1944.

Q. Now, Mr. Johnson, Counsel asked us last night to get some information for him regarding the Quartermaster warehouse; the Rainier Vista

(Testimony of George Johnson.)

Project; the cold storage project and the Coast Guard Project, and particularly the progress schedules. We made an effort, did we not, to locate the progress schedules in your warehouse last night?

A. We were over to the warehouse trying to find the progress schedules, and in refreshing my mind——

Q. (Interposing): Well, did we find any?

A. We didn't find any.

Q. Can you give an estimate—first of all, with Counsel's permission, may I read the dates?

Mr. Payne: Yes. I have no objection.

Q. (By Mr. Potts): I will ask you if these dates are corerct, the date of the contract for the Quartermaster warehouse as July of 1941?

A. Yes.

Q. That was when it was entered into?

A. That was when the contract was entered into.

Q. And for the Rainier Vista Project, September, 1941? A. That is correct. [467]

Q. And the cold storage project, June, 1942?

A. That is right.

Q. And the Coast Guard, May, 1942?

A. That is correct.

Q. Now, can you tell the Court how much of the work—you had personal charge of the Quartermaster warehouse, did you not? A. Yes.

Q. And you were familiar with the progres generally of the Ranier Vista? A. Yes, sir.

Q. Can you tell the Court approximately how much of that work was completed, first, on the

(Testimony of George Johnson.)

Quartermaster warehouse when this first limited partnership was formed, to wit, Febraury 24, 1942?

A. Well, I would say it possibly was completed close to 40 per cent.

Q. Now, with respect to Rainier Vista, what would you estimate that?

A. Well, that was not as far on. We had had considerable trouble there on account of getting material, and also it was right in the rainy season. I would say between 25 and 30 per cent.

Mr. Potts: Do you want this information about these notes, or will you wait until Mrs. Potts gets here? [468]

Mr. Payne: Let us wait until Mrs. Potts gets here.

Mr. Potts: Very well. Your witness.

Cross-Examination

By Mr. Payne:

Q. Mr. Johnson, in connection with your testimony relating to the Quartermaster—what do you call it——

A. (Interposing): Quartermaster warehouse.

Q. (Continuing): I show you the partnership return for 1942, in evidence as Respondent's Exhibit B, and call your attention to the schedules of contracts completed that year, and ask you if that is the same item listed as Quartermaster on that schedule. I ask you if that is the same contract.

A. That is correct.

Q. The Quartermaster contract?

(Testimony of George Johnson.)

A. Yes.

Q. And the total cost of that contract?

A. The total cost of that contract was $1,324,-737.53.

Q. And what was the amount received under that contract by the partnership?

A. This column shows a complete—that is the complete column. (Indicating.)

Q. That is the completed figure on that?

A. Well, I am asking you. Is this the column that shows when the job was completed? I am asking that for my [469] information. This column was when the job was completed, is that right?

Q. Yes. A. $1,559,593.73.

Q. And the gross profit on that contract?

A. Gross profit of $234,866.20.

Q. And that is the one you say was about 40 per cent completed at the time of the formation of the first limited partnership?

A. That is right. This is the gross profit, as I understand it.

Q. Yes. That is the gross profit, all of which was reflected—all of the profits which went to the respective parties?

A. I am not a bookkeeper. There was something later on taken out of that there. It looks like a pretty good profit but——

Q. (Interposing): I am not trying to trick you, Mr. Johnson. The return is in evidence and there is no question about the partnership profit as such. I am simply trying to identify that in the record.

(Testimony of George Johnson.)

Now, the Rainier Vista is the one that you testified about as being about 25 or 35 per cent completed at the time of the formation of the first limited partnership, is that right? A. Yes. [470]

Q. And the cost of that? A. $1,551,601.48.

Q. And the total amount received under that contract? A. $1,757,355.87.

Q. And the gross profit shown by the returns?

A. $201,754.39.

Q. That is $201,000? A. Yes, sir.

Q. You gave testimony about these two contracts entered into in 1941, where the partnership was referred to as consisting of three general partners and ten limited partners, did you not?

A. Yes, sir.

Q. You had done work for the Navy Department before, had you not? A. Oh, yes.

Q. They knew you three general partners pretty well? A. I think so.

Q. Did they make any inquiries of you about the limited partners when you came to sign these contracts?

A. I really don't know where they got this information, but they got it evidently.

Q. But you don't remember any discussion with them about that?

A. I don't remember any discussion with them about that. [471]

Q. Now, Mr. Johnson, you are familiar with the general setup of the first limited partnership, aren't you? A. Yes.

(Testimony of George Johnson.)

Q. And the amount of stated capital which went into that partnership—$105,000, is that correct?

A. Yes.

Q. I show you the partnership return again, Respondent's Exhibit B and call your attention to the first schedule in that return, showing shares in 105th, and then it lists, 15 for Albin, 15 for George and 15 for John. Now, what do those represent according to your understanding?

A. Well, those are thousand dollars, aren't they?

Q. Well, that is what I am asking you. That means $15,000 out of the $105,000 stated limited partnership capital?

A. Yes. I don't know how it came about. We all decided on $20,000, and the first time that I knew of that was in this Courtroom on this, that it was intended then—it was $20,000 for each partner and $20,000 for each group of children.

Q. Belonging to each partner? A. Yes.

Q. How did the change come about?

A. I don't understand it yet how it came about. The first time I knew about it was after we got into this Courtroom.

Q. But you corrected it in the year 1943? [472]

A. Yes. It was a mistake in the bookkeeping of some kind, and how it came about, I really don't know yet.

The Court: Let me make a comment that I think might be important in this case. Mr. Potts, you give attention to this. If the Court should decide

(Testimony of George Johnson.)

that the limited partnership is a valid partnership, it would seem that instead of these general partners being taxed—each one 15/105 for income—it would be 20/120 or 1/6?

Mr. Potts: I think that that is correct. I think that that was the intention as the evidence shows it.

The Court: As I understand it, these individual partners probably did not return 1/6 income. On they contrary they return apparently for the first year 15/100. Is that correct?

Mr. Payne: That is according to my statement. That is what I was going to ask this witness. That is right, Your Honor.

The Court: In any event it should be 1/6 each.

Mr. Potts: I am sure that the testimony is clear in that respect, and that it is the fact that that was the intention of the formation, that the interest of the general partners would be equal to the interest of the limited partners, who were their children.

The Court: Now you may proceed. I just wanted to clear that up. [473]

Mr. Payne: I was wondering, Your Honor, if there was any necessity for the Respondent amending its pleadings to cover that point.

The Court: I think you might well do that.

Mr. Potts: That would just conform to the proof, would it not?

Mr. Payne: Yes.

The Court: I think you might as well do that.

Mr. Payne: Well, we will make a motion at this time for leave to amend.

The Court: Leave will be granted to amend. I

(Testimony of George Johnson.)

suppose since we all know what the situation is, you may file that by, we will say, June 20th.

Mr. Payne: That will be fine. Thank you. I will do that.

Q. (By Mr. Payne): Mr. Johnson, how did you determine among yourselves on this $20,000 for the limited partners coming from each family of the general partners? I call your attention to the fact that some of these children start out in this parnership—for example, Lloyd had a stated interest of $10,000, is that correct?

A. That is right.

Q. And Bernice Wallin had how much?

A. $10,000.

Q. $10,000? A. Yes, sir. [474]

Q. Whereas——

A. (Interposing): John's three children had $6,666.66, each one of them—so the three of them had between them $20,000.

Q. Take Roy, for example, he only got $6,666.66, is that right?

A. Yes. In other words, the $20,000 was divided among the three then.

Q. Here is what I am getting at, though Roy, according to the testimony did render some services, which has been covered by the testimony, and the girls rendered none, yet some of the girls had a larger stated interest than Roy, for example. How do you explain your reason for that?

A. Well, in other words, my daughter, she had $10,000——

(Testimony of George Johnson.)

Q. (Interposing): But rendered no services.

A. And rendered very little services.

Q. Well, she rendered no services in fact, isn't that correct?

A. Well, I would not say that, because when you have—I was in this position; that whenever I came home and wanted a little help, why I could always call on my daughter to write a letter, and even if it was 11 o'clock at night she would do it. And if I took a plan home with me and worked on the plan—I am slow at writing, and although I know that game, when I would work on the plan I would have my daughter sitting on the [475] sidelines, and as I read it off and took the measurements off the plan, she would sit there and copy it down and make up a material list. Contracting is a little bit different, or altogether different from any other business that I know of. You know, we cannot just work eight hours. But if we get a plan to figure, we have got to work night and day, maybe some time, for to get that job in. And it was very handy to have somebody that was willing to give you a lift.

Q. Did she do anything like that for you before 1942?

A. Oh, yes. They have all done that during all the years—since they were able to do it. They have rendered that service all the time.

Q. Let me ask you this—the fact of the matter is then that the three general partners decided among

(Testimony of George Johnson.)

yourselves to take in the children from your respective families in exactly the same amount, is that correct? A. That is right.

Q. And you intended to have them in on exactly the same amounts of your stated interests, too—in other words, you expected to have $20,000 in your own name and $20,000 in the children's names?

A. Yes, sir, that is correct.

Q. And the same with each one of the general partners? A. Yes, sir.

Q. And your understanding is that the distributions [476] for the purpose of your individual income tax returns were made on the basis of this schedule in the partnership return of $15,000 for the year 1942?

A. No. My understanding is that the return was made with the idea that I as George Johnson had—in other words, if you divide this partnership in three first, and then each partner divided his amount in two, we have six parts. So, when the return was made out, it should have been made out that my share was 1/6, wouldn't that be it?

The Court: Yes.

Mr. Payne: We will have to develop that by another witness. That is clear now. I didn't think that there was any question about that, but now that it has arisen, we will have to clarify that.

Q. (By Mr. Payne): I do show you, Mr. Johnson, the 1943 return of the partnership, in evidence as Respondent's Exhibit D, and I will ask you if the so stated shares were changed then to 120.

(Testimony of George Johnson.)

A. That is right.

Q. That means to $120,000, doesn't it?

A. That is right, $120,000.

Q. And then Albin and George and John had a $20,000 stated interest each? A. That is right.

Q. And then the children had different amounts, based [477] upon the re-division among the children? A. That is right.

Q. As shown by the testimony.

A. Yes, sir, which totals $120,000.

Q. Mr. Johnson, you have heard the testimony here about this unsuccessful partnership, in which an agreement was signed in January of 1941, Respondent's Exhibit C—that is signed by the original general partners, and Lloyd, Roy and Winston Johnson, is it not? A. Yes.

Q. And Lloyd is your son, isn't he?

A. That is right.

Q. He was the one that you were trying to get into the partnership at that time, I understand.

A. That is right.

Q. Did you sign this partnership agreement with the anticipation or expectation of getting him in?

A. That is right.

Q. And he didn't come in, but he went with Kuney.

A. Well, I really don't remember. I think that he was in the office for some time, and then eventually he was asked to figure this job with Kuney. And in our mind it was just a sort of a friendship gesture to figure this job with Mr. Kuney, because

(Testimony of George Johnson.)

he had known him for several years. But it developed that it became a real partnership. [478]

Q. And then after you found out that he formed a partnership with Kuney, then you came in and formed this new limited partnership in 1942?

A. After he had worked with Kuney for some time, why we then got an idea that we should really make another—that we should make up this partnership, and this was worked in—oh, it was started to work on in the latter part of 1941, and we really had all expectations of having this completed by the end of 1941. But it just was never really gotten all together, because there were a great many people to talk to, and we also were busy with other things, and we sort of let it slide, and that is why it was brought over into 1942.

Q. You are speaking now about the 1941 partnership agreement, Respondent's Exhibit C?

A. Yes. This here was never worked on.

Q. I understand that.

A. And then finally—and then we were still short of finances to really figure on work that was worthwhile—that was profitable. So we then—after some time—some time after that partnership was formed we then got in with the idea that we should take our children in and let each one of them give us a note, which we could use as an asset in our business, and by this building up a backlog, so to speak, to be able to secure bonds. That was our shortcomings all the time. We just had to confer with the bonding company if they would bond us

(Testimony of George Johnson.)

on [479] this job, or bond us on that job, and you realize, when you have got one job, as long as that is not finished, the bonding company considers that as a liability. So to get a bond for another job you had to really have something to show for it before they would go on your bond.

Q. Now, Mr. Johnson, I want to ask you another question. You executed one of the contracts for that Bremerton job in December, 1940, didn't you?

A. Yes. We went—we got that job together with the West Coast Construction Company, as I have already testified.

Q. And you signed other contracts earlier in the year 1941, I believe, for that job?

A. Yes, in addition to it.

Q. Did they have anything to do with the formation—of the attempted formation of this co-partnership, or Respondent's Exhibit C in 1941?

A. Well, whether that had anything to do with it, I really don't know but——

Q. (Interposing): Weren't you trying to get a system set up here where you could divide this income with your sons?

A. We were so anxious to get backing, to be able to make a few dollars. We didn't really anticipate —we didn't look very much for the tax part of it. We were first trying to get a setup where we could make the money. I do not know if anyone else gave much of a thought of the tax, because so far [480] we had not been able to make much money.

Now, we actually, by making this setup—we are

(Testimony of George Johnson.)

really in a shape where we have paid in not a little money to Uncle Sam, for which I am glad.

Q. Wasn't the scheme determined to try to divide the income among your family in what you thought was an equitable way? A. Not at all.

Q. The sons were not expected to put in any capital in this 1941 partnership, I am referring to Respondent's Exhibit C, were they?

A. In here we feel that we were somewhat indebted to our sons, because our two sons, or three sons, they were willing to put in their efforts with their fathers when we were down and out, you might say. We were not altogether broke, but we were badly bent.

Now, they were willing to put in an effort with us so that it might be possible for us to make a few dollars, and by making a few dollars we have been able to contribute not a little to Uncle Sam in taxes. We never expected that we would be able to do what we have done, but I think that we have done not so bad.

Q. Let me ask you this, Mr. Johnson. You testified about your difficulties in getting bonds. Tell the Court, if you will, what they require—what the bonding company [481] requires of a partnership when they ask for a bond? Do they require a listing of the assets?

A. By all means. You cannot get any bonds unless you produce a fairly good statement.

Q. Now, before the limited partnership was formed, what did you do, list all of your assets of

(Testimony of George Johnson.)

the partnership, including the assets individually owned by the three of you?

A. Oh, by all means. That is always done.

Q. All right.

A. We had to do that even when we were a corporation. Even though we were incorporated, for to get a bond we had to list everything that we had individually, and you will find—you can look up a surety bond anywheres, and you will find that the owner, or whoever is the contractor, not only signs as the president for the corporation if they are a corporation, but you will find that they most likely list their private assets. That is, I am talking about the small fry, like we were at that time.

Q. Now, let me ask you this, after the limited partnership was formed how did you list the assets on your application for bonds?

A. We listed the Western Construction Company, and we listed George Johnson's assets, and J. A. Johnson's and Albin's.

Q. Would they be listed separately, or together?

A. I really don't know. [482]

Q. Coming back to Respondent's Exhibit B in evidence—the 1942 return—when you would apply for a bond in 1942 would you just list the $105,000 represented by the limited partnership capital on that bond?

A. I would not say so. This is—oh, what would I call it? This is really—you might call it capital stock, isn't that correct?

(Testimony of George Johnson.)

Q. This is the measure of the division of the profits isn't it?

A. Yes, this is the measure of the division of the profits, but——

Q. (Interposing): Will you answer if this is the measure of the division of the profits?

A. Yes. Yes, we called it that.

Q. Yes.

A. We would list the profit, or we would list those—the money that the children put in; the money of George Johnson and J. A. Johnson and Albin, what they had in the bank, we would list that, and as we made a dollar and it would show a little profit on the bank account, we would list that. We would list every penny that we had in the partnership, together with the individual assets.

Q. So the notes that the children gave you three general partners were listed as your private assets in such a statement, is that right? [483]

A. That is right.

Mr. Payne: That is all.

Mr. Potts: That is all.

(Witness excused.)

The Court: I may state that I gave the Commissioner until June 20th in which to file his amended answer. And perhaps I had better fix July 10th as the date within which the Petitioners can file a reply if they think one is needed.

Mr. Potts: Thank you, Your Honor.

The Court: Now, is that all of your testimony, Mr. Potts?

Mr. Potts: Yes, Your Honor. That is the Petitioners' case, Your Honor.

(Whereupon the Petitioners rested their case.)

The Court: You may proceed, Mr. Payne.

Mr. Payne: Yes, Your Honor. Just a moment, please. I will call Mr. Von Harten.

Respondent's Case

Whereupon,

JOHN H. VON HARTEN

called as a witness on behalf of the Respondent, being first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Payne:

Q. What is your name? [484]

A. John H. Von Harten.

Q. And what is your occupation, Mr. Von Harten?

A. I am a Certified Public Accountant.

Q. Have you for many years handled some of the accounting for the Western Construction Company? A. Yes, sir.

Q. And the general partners of that company?

A. Yes, sir.

Q. And the special partners of that company?

A. Yes, sir, but not all.

(Testimony of John H. Von Harten.)

Q. Some special partners had their returns prepared elsewhere, but generally you handled the returns for the Johnson family? A. Yes, sir.

Q. Mr. Von Harten, I show you Respondent's Exhibit B, the 1942 return of the partnership of the Western Construction Company, and I will ask you if you prepared that return.

A. Yes, sir.

Q. I call your attention to the schedule inside of that return showing the stated interests of the general and special partners. Where did you get that information, Mr. Von Harten?

A. Just what information do you refer to?

Q. Showing the interests of the respective partners, Albin Johnson, $15,000, and the other general partners in the same amount of 15 portions of the 105th interest in the [485] partnership.

A. I think that that was in accordance with the partnership agreement.

Q. Now, can you show me what the total profit —the distributable profit to the limited and general partners—is on that return, Mr. Von Harten?

A. $420,408.21.

Q. Can you turn to the return and show how the distribution was shown to the respective partners, in amounts?

A. Well, that is shown in this schedule.

Q. Please state to the Court the amount of the distributions shown on that return to Mr. George Johnson. A. $68,423.89.

(Testimony of John H. Von Harten.)

Mr. Potts: Is that Exhibit B, Counsel, that you are referring to?

Mr. Payne: That is Exhibit B—the partnership return. That is right.

Q. (By Mr. Payne): And I show you, Mr. Von Harten, what purports to be the income tax return of Mr. George Johnson for the year 1942, and I will ask you if you prepared that return?

A. Yes, sir.

Mr. Potts: Is that marked as an exhibit?

Mr. Payne: It is not yet.

Q. (By Mr. Payne): That is George Johnson's return for that year, is it? [486] A. Yes, sir.

Q. And how much profit was reported in that return of George Johnson in the Western Construction Company? A. $68,549.44.

Q. There is a slight discrepancy there between the two figures. Can you reconcile that for the record?

A. There is some profit on the books that is not deductible for income tax purposes but which is on the individual return, such as for charitable purposes, and so on, and that accounts for the difference.

Q. So Mr. George Johnson did report in his individual return his distributive share of the partnership based on a stated 15/105th interest in the Western Construction Company for that year?

A. I think that that is after providing for salaries.

(Testimony of John H. Von Harten.)

Q. After providing for salaries to the three general partners?

A. And in this case Winston A. Johnson.

Mr. Payne: I see. We should like to offer Mr. George Johnson's return in evidence, Your Honor, as the next exhibit number.

Mr. Potts: No objection.

The Court: It will be received as Respondent's Exhibit I. [487]

(Document above referred to was marked Respondent's Exhibit I and received in evidence.)

Mr. Payne: Will Counsel stipulate that the same was true with respect to the return of Huldah Johnson, the wife of George Johnson?

Mr. Potts: Yes, we will so stipulate. I think that that is true, isn't it, Mr. Von Harten?

The Witness: Well, this includes both husband and wife.

Mr. Payne: I didn't hear you, Mr. Von Harten.

The Witness: The $68,000 includes both husband and wife.

Mr. Payne: I beg your pardon. That is the total community distribution?

The Witness: Yes, sir.

Mr. Payne: That is right. And the prior amount was included in George's return, and then the community division was made afterwards?

The Witness: Yes, sir.

(Testimony of John H. Von Harten.)

Mr. Payne: I just want to have it clear that Huldah's return would show 50 per cent.

The Court: One-half of the income reported as the earnings of the partnership?

Mr. Payne: Yes. [488]

Mr. Potts: We will so stipulate if that is the fact. Mr. Von Harten, will you tell me if it is not?

The Witness: Yes, I think that that is true.

Mr. Payne: I offer for identification the income tax return of J. A. Johnson for 1942.

The Court: It will be marked for identification as Respondent's Exhibit J.

(The document above referred to marked Respondent's Exhibit J for identification.)

Mr. Potts: We will have no objection to this being received in evidence.

The Court: All right.

Mr. Payne: I just want to develop that in each one of these three general partners' cases, that their distributive share of the partnership was based on a stated 15/105th interest after the deduction of salary shown on the 1942 partnership return. Is that correct, Mr. Von Harten?

The Witness: Yes, sir.

Mr. Payne: We offer Mr. John Johnson's return in evidence, and it is understood that one-half of the community profit stated therein was the profit of Mr. J. A. Johnson's wife, one of the Petitioners here.

Mr. Potts: It is so stipulated.

(Testimony of John H. Von Harten.)

The Court: It may be received in evidence. [489]

(The document above referred to, previously marked Respondent's Exhibit J for identification, received in evidence.)

Mr. Payne: I offer in evidence the income tax return of Albin Johnson for the year 1942, for the same purpose.

Mr. Potts: No objection.

The Court: It will be received in evidence as Respondent's Exhibit K.

(The document above referred to, marked Respondent's Exhibit K for identification, received in evidence.)

Q. (By Mr. Payne): Mr. Von Harten I show you Respondent's Exhibit K and I will ask you if distribution was made to Albin on the same basis?

A. Yes, sir.

Mr. Payne: And, if Your Honor please, Mrs. Albin Johnson's return is not before the Court, but we have stipulated the percentage of the distribution which constitutes his taxable income and the percentage which belongs to his wife.

The Court: Very well.

Mr. Payne: If Your Honor please, in addition to the original returns of the three general partners, amended returns were subsequently filed to take care of small amount of capital gain. I think, to complete the record in every case, [490] we should offer the amended returns for that purpose, and I

(Testimony of John H. Von Harten.)

now offer the amended return of George Johnson for the year 1942.

Mr. Potts: No objection.

The Court: It will be received in evidence as Respondent's Exhibit L.

(Document above referred to, marked Respondent's Exhibit L for identification and received in evidence.)

Mr. Payne: And the amended return of J. A. Johnson for 1942.

The Court: It will be received in evidence as Respondent's Exhibit M.

(The document above referred to, marked Respondent's Exhibit M for identification, and received in evidence.)

Mr. Payne: And the amended return of Albin Johnson for the year 1942.

The Court: It will be received in evidence as Respondent's Exhibit N.

(The document above referred to, marked Respondent's Exhibit N for identification, received in evidence.)

Q. (By Mr. Payne): Mr. Von Harten, I show the partnership return for the [491] year 1943, Respondent's Exhibit D, and ask you if the distribution of profit to the three general partners was on a different basis from that shown in the 1942 return? A. Yes, sir.

(Testimony of John H. Von Harten.)

Q. Based on what? Will you read that for the record?

A. The share was one-sixth. The salary was $7,500 each.

Q. That is for what—a six months' period?

A. Yes.

Q. To what date?

A. Six months ending December 31, 1943.

Q. You say a one-sixth interest, or, in other words, 20/120ths of the partnership interest?.

A. Yes.

Q. For each of the general partners?

A. Yes, sir.

Q. And the salaries stated in that return are just for a six months' period, you understand?

A. That is right, yes, sir.

Q. Mr. Von Harten, do you know whether a return was prepared for this partnership for the period of January 1 to June 30, 1943?

A. Yes, sir. It was.

Mr. Payne: I would like to explain to the Court that we do not have a copy of that return, and we haven't been able to get it, and our evidence is somewhat incomplete in [492] that respect, and I thought that we should explain it to the Court. We do not have in our possession the partnership return for that first six months' period.

The Court: Does the taxpayer have it? If he does, why a copy may be received.

Mr. Payne: I do not think that we are in any material difference about it, because the income is not in controversy. It is just a division.

(Testimony of John H. Von Harten.)

The Court: I imagine that the first six months of 1943 are divided on a basis of the capital interest of $50,000 each to the general partners.

Mr. Payne: I am sure that we can find that out.

Q. (By Mr. Payne): Do you happen to know, Mr. Von Harten, about that?

A. Well, when the agent's auditor went into this matter he said that no return for the first six months had been received, and I typed a copy for him. Now, where it went, I don't know.

Q. Can you tell the Court whether the division was made on the same basis as the division shown on Exhibit D?

A. No, I cannot without going into it.

Q. Can you tell from the partnership books?

A. Not without a lot of computations.

Mr. Potts: You are speaking of 1942 and 1943—those are the two years. One year was forgiven, but you are [493] speaking of the partnership returns, are you?

Mr. Payne: I am speaking of the partnership returns for the first six months of 1943, Mr. Potts. That is while the first limited partnership was still in operation.

Mr. Potts: And it was not corrected until the new limited partnership agreement was signed.

Mr. Payne: I was mistaken in the question that I asked Mr. Von Harten. I assumed that the distribution was made on the basis of the 1942 returns.

Mr. Potts: Well, I would assume so too. Just a minute.

(Testimony of John H. Von Harten.)

Mr. Payne: We will call Mrs. Potts to find out the answer to that, Your Honor.

The Court: Maybe you will be able to find that return some place.

Mr. Payne: I had temporarily overlooked it, Your Honor, that we didn't have it. I had it in mind some time ago and intended to find it.

Mr. Potts: I think we are willing to stipulate that it was made——

Mr. Payne (Interposing): That the distribution to the individuals was made——

Mr. Potts (Continuing): ——was made on the basis as the 1942 return.

Mr. Payne: On the same basis as the 1942 return? [494]

Mr. Potts: Yes, after the filing of the first certificate of formation of the limited partnership.

Mr. Payne: In other words, the purported limited partnership agreement was filed the same?

Mr. Potts: Yes.

Mr. Payne: Up until the execution of the second limited partnership?

Mr. Potts: Yes. I think that was Mrs. Potts' testimony yesterday, that the books were corrected. His Honor asked that question if you will remember.

The Court: I believe so and this mistake in the capital interest of the general partners was not corrected until the new partnership agreement was signed.

Mr. Potts: That is the evidence.

(Testimony of John H. Von Harten.)

Mr. Payne: If your Honor please, I am sometimes a little bit at a loss to know whether we should put all of the returns in evidence. Ordinarily it is a good practice, and particularly in this case, where there is a possible necessity of recomputation of tax based on the larger allocation of profits to the general partners for the period in which the first limited partnership was in operation, which covered substantially all of 1942 and six months of 1943—I think it is necessary that he put in the 1943 returns at least.

The Court: You may do that if you care to.

Mr. Potts: I have no objection. [495]

Mr. Payne: If your Honor please, I believe that we should put in the returns of all the years before the Court in evidence.

The Court: You may do so.

Mr. Potts: I have no objection.

The Court: It sometimes is helpful.

Mr. Payne: How is that?

The Court: It sometimes is helpful. Sometimes some questions arises——

Mr. Payne (Interposing): I will put in the 1943 return of Mr. George Johnson.

The Court: That will be received in evidence as Respondent's Exhibit O.

(Document above referred to marked Respondent's Exhibit O and received in evidence.)

Mr. Payne: And I will offer in evidence the 1941 return of Mr. George Johnson.

(Testimony of John H. Von Harten.)

The Court: Which will be received in evidence as Respondent's Exhibit P.

(Document above referred to, marked Respondent's Exhibit P, received in evidence.)

Mr. Payne: And the 1945 return of Mr. George Johnson.

The Court: It will be received as Respondent's Exhibit Q. [496]

(Document above referred to marked Respondent's Exhibit Q received in evidence.)

Mr. Payne: With the understanding that the community profits stated therein, divisible between him and his wife Huldah, are also before the Court. Is that all right, Mr. Potts?

Mr. Potts: Yes.

The Court: Very well. That is understood and stipulated.

Mr. Payne: We offer, if your Honor please, the 1943 return of Mr. J. A. Johnson.

The Court: That will be received as Respondent's Exhibit R.

(Document above referred to marked Respondent's Exhibit R, received in evidence.)

Mr. Payne: We have detached from that the consent of the extension of the period, because there is no question before the Court about that.

The Court: Very well.

Mr. Payne: It would just encumber the record. And we offer the 1944 return of Mr. J. A. Johnson.

(Testimony of John H. Von Harten.)

The Court: Received as Respondent's Exhibit S.

(Document above referred to marked Respondent's Exhibit S, received in evidence.)

Mr. Payne: And we offer the 1945 return of Mr. J. A. Johnson. [497]

The Court: Received as Respondent's Exhibit T.

(Document above referred to marked Respondent's Exhibit T, received in evidence.)

Mr. Payne: With the understanding that similar returns were filed by his wife, Ellen Johnson, also before the Court, showing her community interest.

The Court: Is that stipulated, Mr. Potts?

Mr. Potts: Yes, your Honor.

Mr. Payne: We offer Mr. Albin Johnson's return for 1943.

The Court: That is received as Respondent's Exhibit U.

(Document above referred to, marked Respondent's Exhibit U, received in evidence.)

Mr. Payne: And Mr. Albin Johnson's return for the year 1944.

The Court: That is received as Respondent's Exhibit V.

(Document above referred to, marked Respondent's Exhibit V, received in evidence.)

Mr. Payne: And Mr. Albin Johnson's return for the year 1945.

(Testimony of John H. Von Harten.)

The Court: It will be received as Respondent's Exhibit W.

(Document above referred to marked Respondent's Exhibit W, received in [498] evidence.)

Mr. Payne: And, as stated before, the community and separate division between them has already been stipulated by the parties.

The Court: Very well.

Q. (By Mr. Payne): Mr. Von Harten, were you familiar with the details leading up to the formation of the limited partnership in 1942?

A. No, I didn't have very much to do with that. I think Mr. Potts and——

Q. (Interposing): Do you know who prepared that agreement?

A. I am not sure, but I always took it for granted that Mr. Potts did.

Q. Did you, in your accounting of the income tax affairs of the Johnson family, have any discussion with them about this division with their children for the purpose of reducing their Federal taxes?

A. I do not recall any specific conversation along that line.

Q. Or with Mr. Potts?

A. Well, I cannot say. I do not remember whether I talked to him about that particular thing or not.

Q. You were not instrumental then in helping to set up this limited partnership?

(Testimony of John H. Von Harten.)

A. I do not recall doing anything, I would say, along that line. I knew that it was done, and I took some interest [499] in it. I audited the books, and I took some interest to see what the terms were so that the income would be recorded correctly.

Q. Did you prepare for Mr. Potts, or for the general partners, tax computations showing about what their taxes would be on certain stated incomes if included in the returns of the three general partners, and what it would be if it were divided with members of their families?

A. Mr. Payne, I do not remember of having done so.

Q. You do not remember of ever having done that? A. No, sir.

Mr. Payne: That is all.

Cross-Examination

By Mr. Potts:

Q. That matter, Mr. Von Harten, was never called to your attention, was it?

A. Well, I do not remember all of the conversations that I have had. That is a long time ago. I cannot say if it was, nor would I want to say if it was not.

Q. May I ask you this, the first time that you learned about the formation of the limited partnership was when I showed you the articles after they had been recorded and published in the local paper, is that right?

(Testimony of John H. Von Harten.)

A. According to my memory I think that is correct.

Mr. Potts: That is all, thank you. [500]

Mr. Payne: That is all.

(Witness excused.)

Mr. Payne: I would like to call Mr. Alvin Johnson for a moment please, if your Honor please.

The Court: Very well.

Whereupon,

ALBIN JOHNSON

a witness previously called on behalf of the Petitioners, recalled as a witness on behalf of the Respondent, having been previously sworn, was examined and testified as follows:

Direct Examination

By Mr. Payne:

Q. Mr. Johnson, is Elsie your daughter?

A. That is right.

Q. And she was married to a man by the name of Keil? A. Yes, sir.

Q. And Elsie Keil was one of the limited partners in the 1942 partnership? A. Yes.

Q. And that continued during the 1943 partnership also?

A. That is right, and it still continues.

Q. Did you know that Elsie and her husband filed returns and showed the partnership profit as equally belonging to each?

(Testimony of Albin Johnson.)

A. I am not so sure how that was done. [501]

Q. You don't know? A. No.

Q. When did Elsie and her husband have marital difficulties between them, do you remember?

A. No, I don't. I don't remember when that was.

Q. Was Elsie divorced from Rudolph Keil?

A. Yes.

Q. Do you know what year that was?

A. I don't really remember that. About 1944 I guess, wasn't it?

Q. Do you remember the matter coming up about the division of their property and property interests in connection with their divorce?

A. Yes, there was something about that, I remember.

Q. Do you remember the question came up about the treatment of the partnership interest?

A. He signed over his interest in the partnership interest to Elsie.

Q. Did you take the position that that interest belonged to Elsie?

A. No, I did not. I didn't take any position at all at that time.

Q. You did not?

A. No. I never saw Rudolph. I never discussed it with him at all. [502]

Q. Do you know who prevailed upon him to relinquish his claimed interest in that partnership to Elsie?

A. I don't know that anybody prevailed upon him at all.

(Testimony of Albin Johnson.)

Q. But you do know that it was done?

A. I know that it was done.

Q. Do you know who Elsie's attorney was at that time? A. Yes. Mr. Potts.

Q. Mr. Potts? A. Yes, sir.

Mr. Payne: That is all.

Cross-Examination

By Mr. Potts:

Q. Just a minute, Mr. Johnson. First let me have this marked. Will you please mark this, Madam Clerk?

The Court: That will be Petitioners' Exhibit 29 for identification.

(Document above referred to marked Petitioners' Exhibit 29 for identification.)

Q. (By Mr. Potts): Mr. Johnson, showing you Petitioners' Exhibit 29 marked for identification—I am sorry—I thought that those were the original signatures. I am sorry, Your Honor. I thought that I had the original signatures on a property settlement agreement, but I have not. I would like to offer it, but I do not know how I can identify it. [503]

The Court: Well, I should think it is rather immaterial anyhow, it seems to me—a property settlement between them. I do not see how it would throw any light on this proceeding.

Mr. Potts: Then I will withdraw Petitioners' Exhibit 29 for identification.

The Court: Yes. It may be withdrawn.

(Document above referred to, previously marked Petitioners' Exhibit 29 for identification withdrawn.)

Mr. Potts: That is all.

Mr. Payne: I have no further questions.

(Witness excused.)

Mr. Payne: We would like to call Mrs. Potts for a few questions.

Whereupon,

MRS. LUCILLE EASTERBROOK POTTS

recalled as a witness on behalf of the Respondent, having been previously sworn, was examined and testified as follows:

Direct Examination

By Mr. Payne:

Q. Mrs. Potts, you were testifying from the books and records of the Western Construction Company yesterday, and there seems to have been just a little misunderstanding about the stated partnership capital for the first partnership [504] and how it was worked out, and the change which was made in the second limited partnership which was formed in 1943. Will you turn to the books and tell the Court the amount of each general partner's stated capital contribution to the first limited partnership February 24, 1942?

A. $15,000.

(Testimony of Mrs. Lucille Easterbrook Potts.)

Q. For each of the three?

A. That is right.

Q. And then the family of each—the children of each of the general partners had an aggregate of $20,000, I believe, in the first partnership?

A. That is right.

Q. And that continued until the partnership formed June 30, 1943? A. That is right.

Q. Then what change was made in the stated capital investment of the three general partners?

A. It was increased to $20,000.

Q. There was an an increase to $20,000 each?

A. That is right.

Q. Where did that additional $5,000 for each come from, Mrs. Potts?

A. They put it in with their own money.

Q. You had another account on the books, didn't you, of the personal accounts of the individual general partners? [505] A. Yes, sir.

Q. Did you just make a bookkeeping entry of taking that out of the personal account of the partnership and putting it into the stated capital account of the limited partnership?

A. I don't remember whether it was a bookkeeping entry, or how.

Q. Will your books show—turn to the personal accounts of the three general partners at or after June 30, 1943.

A. I think it was just an entry.

Q. What do the books show with respect to that? Will you please read it to the Court in each

(Testimony of Mrs. Lucille Easterbrook Potts.)

case? A. "June 30, 1943, to capital, $5,000."

Q. That is for each of the three?

A. Yes, sir.

Q. You are reading now from Albin Johnson's account? A. Yes. They are all the same.

Q. Now, will you reach each of the others, Mrs. Potts?

A. "June 30, 1943, George Johnson, to capital, $5,000."

Q. And that is from what—from his personal account? A. Yes, sir.

Q. And the one that you just read for Albin was from his personal account? A. Yes, sir.

Q. Now, the next one, John A. Johnson.

A. "June 30, 1943, to capital, $5,000," for J. A. Johnson. [506]

Q. Now, Mrs. Potts, I was a little bit foggy last evening, I will admit, on the matters that you testified to from the audit report. You read into the record yesterday afternoon the total capital of the three general partners before the formation of the first limited partnership, did you not?

A. Yes.

Q. And then when Mr. Potts called you back on the stand you testified from an audit report——

A. (Interposing): No, I testified from the books, but I corrected it. I had made a mistake on the other figures, Mr. Payne.

Q. Now, since I am confused about it, it may be that the record is confused, and I will ask you, with

(Testimony of Mrs. Lucille Easterbrook Potts.)

the Court's permission, if you will please repeat that for me.

A. I will have to figure it all out again now.

Q. Well, we will have quite a little time left this morning. I would like to get that one statement straightened out. A. All right.

Q. And since we have some time left, will you do that? What was the total capital of each general partner before the formation of the first limited partnership?

A. I will have to give it to you as of January 1, 1942.

Q. All right [507]

A. Albin Johnson $44,465.16.

Q. Before you leave that, please, was there any other statement or entry bringing that down to date February 24, 1942, when the first limited partnership was formed?

A. What do you mean—a statement—what do you mean, Mr. Payne?

Q. A statement of a change in his capital account.

A. Well, his account changed every day. The Johnsons did not have any checking account, and they drew money every day or so. I mean, the account would change every day, if they drew a check.

Q. And you charged those checks to their personal accounts, did you?

A. They didn't have any personal checking account ever.

(Testimony of Mrs. Lucille Easterbrook Potts.)

Q. They used the company's checking account for their personal use then?

A. Not for their personal use, but they drew against it at the time.

Q. So that is the last entry you have on the books showing capital of Albin Johnson before the formation of the new limited partnership?

A. Yes.

Q. Now, will you state for the record what change took place at the formation of the partnership and what his account showed after that [508] date?

A. Well, we put $15,000 into his capital account and $29,465.16 into his personal account.

Q. All right. Now, take up the next general partner in the same way, will you please?

Mr. Potts: Before you turn to that, may I have those figures again?

The Witness: We put $15,000 into his capital account and $29,465.16 into his personal account.

Q. (By Mr. Payne): You have now Mr. George Johnson's account, have you?

A. Yes. Well, I had it all figured out yesterday, but I have to check and subtract figures here now to figure it again, because there is interest and various other things.

Mr. Potts: I will give you a piece of paper and see if that will help you. (Handing paper to witness.)

A. Well, on the books here it shows—the first figure I read yesterday——

(Testimony of Mrs. Lucille Easterbrook Potts.)

Q. (By Mr. Payne, interposing): Please give that for the record again and we will start from there.

A. Well, there was an error. You don't want it back in the record again wrong, do you?

Q. Well, let us get it corrected. That is what we want, to get the corrected amount.

A. All right. Well, he had $75,870.04 in his [509] personal account, and $15,000 in his capital account. But this $75,000 included some figures that were deducted out.

Q. Will you explain those to the Court?

A. Well, there was some real estate that we always deducted out, and then we finally took it off the books.

Q. Will you show the amount of that?

A. Should I get the journal entry and look it up?

Q. Was that in your previous testimony of yesterday—the amount of that?

A. Not the amount; the corrected amount was.

Q. The amount taken out was not shown?

A. No.

Q. How long would it take you to get it for the Court?

A. Well, ten minutes or fifteen minutes. I can do it right here. I will look up the journal entry and show you. I mean, I have not looked at these books so much lately. It will take me a minute or two.

Q. Those, I remember, you testified were assets which had been on the books for many years?

(Testimony of Mrs. Lucille Easterbrook Potts.)

A. That is right.

Q. In the names of George Johnson and J. A. Johnson?

A. In the names of George Johnson and J. A. Johnson, yes, sir.

Q. And how long after were they taken out—how long after the formation of this new partnership? [510]

A. Well, they never were—I mean, they might have been on the books, but when the statements were made up, or anything, they were always treated separately. I mean, they might have had a sheet in here.

Mr. Payne: Your Honor, could we reserve that, and maybe if we had a short recess, in a few moments we could get the witness to check those amounts and we could come back to them.

The Court: Very well.

Q. (By Mr. Payne): Now, Mrs. Potts, you understand from the testimony that the capital account of the first limited partnership was regarded as $105,000, is that right? A. That is right.

Q. And that was used for the basis of making distribution of profits, is that right?

A. That is the way I understand it. I had never distributed it.

Q. I understand. Now, those accounts—well, take at the end of 1942, there was a substantial amount of profit credited to the account of each partner, was there not? A. Yes, there was.

Q. And the testimony has gone in on that. The

(Testimony of Mrs. Lucille Easterbrook Potts.)

capital stock, for purposes of division of profits for the next period, was not changed by reason of the fact that the profits [511] were left in the business, were they? A. No.

Q. No matter whether a partner left his profits in or drew them out, his basis for distribution of profit was always computed on the original stated investment, isn't that right?

A. Yes. That is the way we always did.

Q. And, take for example, later on, after the 1943 partnership was formed and the stated interests were changed, then the testimony showed that some later years certain of the partners drew out very large amounts of cash. That is your recollection, isn't it? A. Yes, I think it is.

Q. And others drew out very little except what was necessary for tax payments?

A. I do not know what they used it for. Some drew out much less than others.

Q. Take, for example, when Roy drew out some $40,000—you recall that, do you?

A. Yes. I do.

Q. And no change was made in his stated interest for distribution of profits, was there?

A. No, sir.

Q. It always remained on the basis of his original contribution? A. Yes. [512]

Q. Either the 1942 or 1943 partnership?

A. That is right.

Q. And the general partners left some of their profits in the business, too, I understand?

(Testimony of Mrs. Lucille Easterbrook Potts.)

A. Yes, they did.

Q. And their percentage of distribution of profits was not changed by reason of the fact that they left their earnings in the business? A. No.

Q. Mrs. Potts, you were going to get for us this morning the amounts of borrowed money in 1942, particularly, and in 1943. Do you have those, Mrs. Potts?

A. When the limited partnership was started in 1942 they owed the bank $80,000, which had been owing for some considerable time. And then on July 30, 1942, there was $50,000 borrowed from the bank. Those are the only borrowings—the only money that was borrowed.

Q. At any time during the years we have before the Court? A. That is right.

Q. I see. And the $50,000 was borrowed from the bank when, you say?

A. On July 20, 1942.

Q. Can you tell, or do you know whether the notes which have been the subject of testimony here were used as the basis [513] for getting that loan—if you know? I am just asking you if you know.

A. I really don't know. That was way back in 1942.

Q. I see. Mrs. Potts, you have heard the testimony about the profits here in 1942 and the contracts which were in process of construction. You understand that the profits are reported on the basis of completion of the contract, don't you?

A. Yes, and they always have been.

Q. So if you begin a contract in one year which

(Testimony of Mrs. Lucille Easterbrook Potts.)

is only partially completed, and you do not complete it until the subsequent year, the profit is reflected as to that contract in the return of the year in which it is completed? A. That is right.

Q. And that was true with respect to 1942 on the Quartermaster contract and the Rainier Vista contract? A. That is right.

Mr. Payne: If Your Honor please, I believe that that completes the Respondent's case with the exception of the figures that Mrs. Potts is going to get for us. If we have a brief recess, I think that we can conclude our case then.

The Court: We will recess until fifteen minutes after 11 so as to give her time. If she gets it sooner than that, we will reconvene sooner.

Mr. Payne: Very well.

(Thereupon a recess of 15 minutes was taken.) [514]

The Court: You may proceed, Mr. Payne.

Mr. Payne: Mrs. Potts, will you please resume the stand?

Whereupon,

MRS. LUCILLE EASTERBROOK POTTS resumed the stand for further examination.

Direct Examination
(Continued)

By Mr. Payne:

Q. Mrs. Potts, do you now have the information which we were discussing before recess?

A. I have.

Q. Will you state then for the record the capital account of each general partner before and after the formation of the first limited partnership?

A. Before and after?

Q. Yes. A. Oh, I see.

Q. Take up each partner separately.

A. J. A. Johnson, before the formation of the first limited partnership, had $29,140.55.

Q. That was in the acknowledged partnership account? A. That is right.

Q. All right. Now, what was the amount—do the books show any change in that amount upon the formation of the new partnership? [515]

A. Then he had $15,000 in his capital account—he put $15,000 into his capital account.

Q. Out of $29,000? A. Yes, sir.

Q. What about the rest. Did he have a personal account then of the balance of that—the difference between the $15,000 and the $29,000?

A. Well, at the time that the partnership was formed this transfer of real estate I am talking about had not been——

(Testimony of Mrs. Lucille Easterbrook Potts.)

Q. (Interposing): This $29,000 does not include the real estate, does it?

A. Not his own personal real estate, no.

Q. I think it would be clearer for the record if you would state the total amount, and how much real estate was taken out, and what was done with that.

A. $97,535.58 on our books, which included maybe real estate that had belonged to George Johnson and J. A. Johnson since—oh, I think some of it had belonged to them since 1925, or way back when. And it had been put on the partnership books, but always considered as their separate property. And in setting up the accounts correctly we took that real estate and stuff that belonged to the two of them off the books.

Q. And where did you put it?

A. In a little set of books that we called "J. A. Johnson and George Johnson, Partners." [516]

Q. Didn't you keep it in the same set of books under personal account?

A. In these books? (Indicating)

Q. Yes.

A. No. They had another separate little account.

Q. I thought you showed the transfer of that from this partnership account to a personal account in the same records here?

A. No, no. It was taken out of their personal accounts. It was taken out of their personal accounts, and then they started a little partnership—not a little partnership but a little, separate set of

(Testimony of Mrs. Lucille Easterbrook Potts.)

books called "J. A. Johnson and George Johnson," which did not have much money.

Q. You did not state the amounts that were transferred.

A. J. A. Johnson, $68,395.03; and George Johnson, $51,717.13, and that is the amount of real estate that was transferred. (Indicating.)

Q. Your testimony yesterday was that they continued to use those assets for their personal loans, the same as they had previously done.

A. The same as they did on their residence and anything that they had. You know, they always had given their residences or anything that they had personally as security at the bank and to the bonding company.

Mr. Payne: That is all. [517]

Cross-Examination

By Mr. Potts:

Q. This real estate belonged to J. A. Johnson and George Johnson before Albin Johnson came into the partnership then in 1934?

A. Oh, yes. Some of it I think they bought in 1920 and 1925, or some such time as that.

Q. Do you know how the value of this real estate was established for your records?

A. Well, the main part of the real estate is the lot up at 9th and Virginia—I think it is two lots—and I think that they got that lot—they had an apartment building and they traded the apartment building for the lot, as I understand it, and the lot

(Testimony of Mrs. Lucille Easterbrook Potts.)

was—and the two lots were put on the books at that time, I think in 1927 or 1928, at $80,000, because the city was growing that way. And then the city took a turn down here some place.

Q. Well, I mean was the value continued as the price here as originally placed, or was it re-appraised from time to time?

A. No. Just $80,000.

Q. Just the purchase price? A. Yes, sir.

Q. So that after the 1929 crash, and so forth, there was no change made in the value of the real estate? [518]

A. No. Besides the real estate there are a couple of other pieces of real estate—other real estate—but that is the largest item.

Mr. Potts: I think that is all.

Mr. Payne: No further questions.

(Witness excused.)

Mr. Potts: If the Court please, Counsel for the Commissioner have been kind enough to call to my attention the fact that in the petition of Lloyd Johnson we have only asked that the Court find that these expenses were reasonable.

Now, Counsel, as I say, has been courteous enough to point out that this issue being before the Court, and Lloyd Johnson being the only one of the limited partners being brought before the Court, and that only on this question of his expenses, that they are afraid that if the holding of the Court should be against the Petitioners, the claim filed by Mr. Johnson would be foreclosed for a refund, and so they

have suggested, in order to protect Lloyd Johnson and Roberta Johnson, that I at this time move the Court for an amendment to amend Lloyd Johnson's petition so that in the event that there should be a holding by the Court unfavorable to the Petitioners—and I mean the other petitioners, the partners—the limited partners—that we then would be in a position through the amendment to protect Mr. Lloyd Johnson's interest.

The Court: I think it might be well for you to amend, [519] setting up that the Commissioner is contending in these consolidated proceedings that the limited partnership is not to be recognized for tax purposes, and you might set it up affirmatively that the Petitioners Lloyd Johnson and Roberta Johnson, his wife, have returned on a community property basis their proportionate part of this income, and that if the Court in its final decision should hold that the limited partnership is not valid, then that they have erroneously returned that, and ask for an over-payment, entrustance.

Mr. Potts: Yes.

Mr. Payne: We have no objection to that, your Honor.

The Court: I think it might be well for you to amend in view of the issues that we have in this case and you will have up until June 20th to file that, and file your amended petitions in both of those docket numbers, the docket numbers of Lloyd Johnson and Roberta Johnson.

Mr. Payne: And we will have a short period of time in which to answer, I presume?

The Court: Yes.

Mr. Payne: Does the Court wish to fix that at this time?

The Court: Until July 5 if you care to file an answer.

Mr. Payne: Thank you. In that connection, your Honor, I think for the protective purposes of the taxpayer [520] Lloyd Johnson and his wife, Roberta, we should put in evidence the returns showing the amount of income from the partnership which were included in the community for 1942, 1943, 1944 and 1945.

The Court: Are you just going to offer one return and then stipulate as to the others, or are you going to offer them all?

Mr. Potts: I think——

Mr. Payne (Interposing): We should offer, I think, the returns for each year for the husband, with the understanding that the wife's return showed the community half of the amount included by the husband.

The Court: Very well.

Mr. Payne: So we offer the 1942 return of Lloyd Johnson in evidence.

The Court: It will be received as Respondent's Exhibit X.

(Document above referred to marked Respondent's Exhibit X and received in evidence.)

Mr. Payne: And the 1943 return of Lloyd Johnson as the next exhibit.

The Court: It will be received as Respondent's Exhibit Y.

(Document above referred to marked Respondent's Exhibit Y and received in evidence.) [521]

Mr. Payne: The correct name on that one, Mr. Reporter, is Lloyd W. Johnson.

And the 1944 original return of Lloyd Johnson.

The Court: It will be received as Respondent's Exhibit Z.

(The document above referred to marked Respondent's Exhibit Z and received in evidence.)

Mr. Payne: And the amended return of Lloyd Johnson for 1944.

The Court: It will be received as Respondent's Exhibit AA.

(The document above referred to, marked Respondent's Exhibit AA and received in evidence.)

Mr. Payne: And the 1945 income tax return of Lloyd W. Johnson.

The Court: It will be received as Respondent's Exhibit BB.

(The document above referred to marked Respondent's Exhibit BB and received in evidence.)

Mr. Potts: If the Court please, could we hold the record open for this purpose, that claims have been made for a refund, in the event that the Court should hold adversely, [522] but that I do not seem to have copies of here, and I should like to have

the opportunity of filing and introducing in evidence copies of those claims.

The Court: Of Lloyd Johnson and Roberta Johnson?

Mr. Potts: Yes.

The Court: They are the only two that we have before us?

Mr. Potts: Yes.

The Court: That would be affected?

Mr. Potts: Yes.

Mr. Payne: No objection. I think that they should be put in for their own protection.

The Court: Yes.

Mr. Payne: And we will agree to hold the record open until copies can be put in.

The Court: You can send them in and they will be received, and they will be marked at that time as exhibits.

Mr. Payne: We can probably put those in with a brief statement between the parties just to identify them.

The Court: That is all right. Just file them at any time.

Mr. Payne: That concludes the Respondent's case, your Honor. We now rest.

(Respondent rested its case.)

The Court: Do you have anything else, Mr. Potts? [523]

Mr. Potts: We have no rebuttal.

* * *

Filed T.C.U.S. July 12, 1948. [524]

The Tax Court of the United States

Docket Nos. 15495, 15496, 15497, 15498, 15499, 15500, 15586, 15588

WESTERN CONSTRUCTION COMPANY, ET AL.,[1]

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Promulgated March 22, 1950.

FINDINGS OF FACT AND OPINION

Petitioner Western Construction Company was created as a limited partnership under the laws of the State of Washington in 1942 and again in 1943. The certificate of formation of the partnership included petitioners J. A., George and Albin Johnson as the general partners and their several adult sons and daughters as the limited partners. Held, on the evidence, petitioner Western Construction Company does not resemble an association in corporate form and is, therefore, not taxable as such. Glensder Textile Co., 46 B.T.A. 176, followed. Held, further, the Western Construction Company is a bona fide partnership composed of the three Johnson brothers

[1]Proceedings of the following petitioners are consolidated herewith: Albin Johnson, Ellen M. Johnson, Huldah Johnson, George J. Johnson, J. A. Johnson, Roberta M. Johnson and Lloyd W. Johnson.

and their several children as set out in the certificate of formation of the partnership and is recognized as such for tax purposes. John A. Morris, 13 T.C. . ., promulgated December 21, 1949, followed.

Ralph B. Potts, Esq., for the petitioners.

Wilford H. Payne, Esq., for the respondent.

In these consolidated proceedings, the Commissioner determined deficiencies in Federal Taxes of petitioners for the years and in the amounts as follows:

Petitioner	Docket No.	Year	Kind of Tax	Deficiency
Western Const. Co.	15495	1942	Income	$ 4,085.00
			Declared Value Excess Profits	49,390.07
			Excess Profits	255,736.68
		1943	Income	4,703.95
			Declared Value Excess Profits	43,432.61
			Excess Profits	233,777.92
		1944	Income	3,152.71
			Declared Value Excess Profits	6,677.60
			Excess Profits	27,574.04
		1945	Income	4,401.33
			Declared Value Excess Profits	18,253.17
			Excess Profits	87,647.08
Albin Johnson	15496	1943	Income	93,780.81
		1944	Income	6,717.05
		1945	Income	23,177.99
Ellen M. Johnson	15497	1943	Income	29,624.73
		1944	Income	2,312.86
		1945	Income	6,529.81
Huldah M. Johnson	15498	1943	Income	30,745.52
		1944	Income	2,385.74
		1945	Income	6,681.15
George J. Johnson	15499	1943	Income	29,872.23
		1944	Income	2,320.75
		1945	Income	6,635.52

Petitioner	Docket No.	Year	Kind of Tax	Deficiency
J. A. Johnson	15500	1943	Income	$29,111.03
		1944	Income	2,262.40
		1945	Income	6,529.81
Roberta M. Johnson	15586	1943	Income	1,285.07
		1944	Income	604.05
		1945	Income	333.50
Lloyd W. Johnson	15588	1943	Income	1,284.76
		1944	Income	604.05
		1945	Income	333.50

The deficiencies result from several adjustments to petitioners' net incomes as disclosed by their returns for the years in question. By appropriate assignments of error petitioners contest these adjustments. The parties agreed by stipulation to an adjustment of most of the issues involved, and effect will be given these stipulations in the recomputation under Rule 50. The stipulations leave for our consideration only two issues:

The first issue is whether petitioner Western Construction Company is taxable as a corporation. This was explained in a statement attached to the deficiency notice of petitioner Western Construction Company as follows:

> It is held that for income tax, declared value excess profits tax and excess profits tax purposes the Western Construction Company under the so-called limited partnership agreements of February 24, 1942, and June 30, 1943, constitutes an association taxable as a corporation as prescribed by Section 3797(a)(3) of the Internal Revenue Code and Section 29.3797-5 of Regulations 111.

Section 3797(a)(3), I.R.C. and section 29.3797-5 of Regulations 111 are printed in the margin.[2 and 3]

[2]Sec. 3797. Definitions. (As amended by sections 120(f), 511, Revenue Act of 1942.)

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

(1) Person.—The term "person" shall be construed to mean and include an individual, a trust, estate, partnership, company, or corporation.

(2) Partnership and Partner.—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

(3) Corporation.—The term "corporation" includes associations, joint-stock companies, and insurance companies.

[3]Sec. 29.3797-5. Limited Partnerships.—A limited partnership is classified for the purpose of the Internal Revenue Code as an ordinary partnership, or, on the other hand, as an association taxable as a corporation, depending upon its character in certain material respects. If the organization is not interrupted by the death of a general partner or by a change in the ownership of his participating interest, and if the management of its affairs is centralized in one or more persons acting in a representative capacity, it is taxable as a corporation. For want of these essential characteristics, a limited partnership is to be considered as an ordinary partnership notwithstanding other characteristics conferred upon it by local law.

The Uniform Limited Partnership Act has been

The second issue is in the alternative, if Western Construction Company is held not to be taxable as a corporation, then whether Western Construction Company constituted a bona fide partnership consisting of the general partners and the several limited partners for the taxable years 1942 to 1945, inclusive, or whether it was a partnership consisting only of the three general partners. This was explained in a statement attached to the deficiency notice of petitioner George J. Johnson as follows:

> In the computation of your net income for each year mentioned it is held that you and your spouse are each taxable upon one-sixth of the net income of the business conducted under the name of Western Construction Co. It is held that for income tax purposes your children, Lloyd W. Johnson, Bernice Wallin, Lorraine Ellingson and Rachel Gustafson were not bona fide partners in the business conducted under the name of Western Construction Co. during the taxable years mentioned.

A similar explanation was given in the deficiency notices of petitioners in Docket Nos. 15496, 15497, 15498 and 15500.

Findings of Fact

The facts which were stipulated are so found. Other facts are found from the evidence.

adopted in several States. A limited partnership organized under the provisions of that Act may be either an association or a partnership depending upon whether or not in the particular case the essential characteristics of an association exist.

Petitioner Western Construction Company was created as a limited partnership under the laws of the State of Washington and filed partnership returns for the taxable years 1942 to 1945, inclusive. Petitioners J. A. Johnson, George Johnson and Albin Johnson are the three general partners of petitioner Western Construction Company. Petitioner Huldah Johnson is the wife of George Johnson and petitioner Ellen Johnson is the wife of J. A. Johnson. Their cases are here solely because of their community property status with their husbands and do not require any separate consideration by the Court. Petitioner Lloyd Johnson is a limited partner of Western Construction Company and petitioner Roberta Johnson is his wife. They have stipulated to an adjustment of their deficiencies. If it is held that the limited partnership cannot be recognized for Federal tax purposes, petitioners Lloyd and Roberta Johnson will be entitled to a refund due to the fact that they have included in their tax returns their share of the profits of Western Construction Company.

Petitioners J. A. Johnson, George Johnson and Albin Johnson are brothers, and as young men they emigrated from Sweden and later became naturalized United States citizens. They settled in Seattle, Washington, and each raised a family of several sons and daughters. These brothers were later to become the general partners and their children the limited partners of petitioner Western Construction Company. The brothers were carpenters by trade, and in 1909 George and J. A. formed a partnership

known as Johnson Brothers to engage in the general construction business. In 1934 Albin was admitted to the partnership under an oral agreement making him an equal partner with his two brothers. The partnership operated under the name of the Western Construction Company with offices at Seattle, Washington. At first the partnership built small homes but gradually expanded into larger lines of construction as their capital increased; however, the business was always run as a family affair. The sons of the partners worked for the company from their early teens during school vacations, and the daughters worked as clerks or stenographers prior to the taxable years involved herein.

In 1935 the partnership suffered a large loss in connection with a contract for the construction of bridge piers at the Grand Coulee Dam in the State of Washington. The loss was approximately $100,000 which was all the money the partners had saved during the many years before. While the partners were not forced into bankruptcy, they were deeply in debt, having pledged their homes and all they owned to the bank, and it was necessary that the bonding company complete the Coulee Dam contract. From 1936 to 1940 the Western Construction Company partnership did not actively engage in the construction business. It was not dissolved, however, but was kept alive for the purpose of paying off creditors and prosecuting its claims against the Federal Government.

To enable the partners to continue in business, obtain necessary loans, and pay off their indebted-

ness, the bank and the bonding company advised that they do business as a corporation. On October 9, 1935, a corporation was organized under the name of Western Construction Company, Inc., and the construction work during the years 1936 to 1940 was conducted by that corporation. The bank insisted that the incorporators and officers of the corporation be Roy Johnson, son of J. A. Johnson; Lloyd Johnson, son of George Johnson; and Lucille Easterbrook, the bookkeeper. In accordance with the agreement the stock was issued to them, but the beneficial owners of the stock were the three Johnson brothers and it was so understood by all the parties. The corporation operated by the three brothers succeeded in obtaining various construction jobs, and after a period of about five years from 1936 to 1941 George, J. A., and Albin prospered sufficiently to pay off the entire indebtedness which the Western Construction Company and the three brother partners thereof had incurred as a result of the Coulee Dam project. It was then decided to dissolve the corporation and revert to the partnership form of business. Prior to the dissolution, the incorporators turned over their stock to the three brothers who then became the officers of the corporation. The dissolution was completed in 1942.

While the corporation was still in existence J. A., George and Albin also did some business as general partners of the Western Construction Company. In 1940 they secured a very large contract known as the West Park Housing project at Bremerton, Washington. This contract was performed as a

joint venture composed of the three partners and another individual because the partners did not have the financial backing themselves to secure the necessary bond. It was later discovered that the other joint venturer was of no real financial help to the partnership; however, in spite of this lack of financial assistance, the agreement required a split of the profits. In 1941 the partnership also received the contract for the Rainier Vista project. When work was first started on this job it was thought that there might be difficulties with the weather, possibly resulting in a large loss as in the case of the Coulee Dam project. The contract, however, was a financial success and was completed by Western Construction Company, the limited partnership and a petitioner herein.

Early in 1941 and prior thereto there were discussions among the three brothers, who had no formal engineering training, and their three sons concerning the formation of a partnership consisting of fathers and sons. Lloyd, George's son, and Roy, the son of J. A., were graduate engineers with considerable experience with other firms. Winston, Albin's son, had attended engineering school for three years and except for a short period of military service has worked for his father and the other Johnson brothers in the construction business. On January 6, 1941, articles of copartnership naming the six individuals as partners were prepared and executed by them. That agreement contemplated preserving in the three fathers the value of the assets then owned by the old partnership and allow-

ing the sons to participate, without any capital investments on their own parts, only in the increase in the value of the new partnership from the date of that agreement. That agreement also provided that each of the six partners should actively work for the partnership; that salaries would be determined and paid the six of them based upon their services and thereafter the partnership profits would be divided equally among the six partners. That partnership, however, never actively operated and no books or accounts were ever set up for it.

The Johnson brothers were anxious to bring their children into the business, especially their sons who had the engineering training the brothers lacked. One of the big problems that confronted the brothers was that largely because of their limited finances, they were unable to obtain bonds in order that they might secure the large and more lucrative government contracts. They endeavored to persuade other companies to join them on bids, but the West Park project at Bremerton indicated that this was not a satisfactory solution. They also tried unsuccessfully to get outsiders to invest in the partnership. Faced with the desire to include their children in the business and with the need of additional financial backing, the brothers decided to form a limited partnership in which the brothers would be the general partners and their adult children the limited partners. This decision was made without discussion with tax counsel, accountants, or attorneys as to whether it would be cheaper to do business as a partnership rather than as a corporation. The pro-

posed partnership contemplated that each of the Johnson brothers would have a capital investment of $20,000 and the children of each of the brothers a like capital investment of $20,000 divided equally among the children becoming limited partners. On February 24, 1942, they formed a limited partnership, Western Construction Company, a petitioner herein, consisting of three general partners, the Johnson brothers, and seven limited partners being their three adult sons and four of their adult daughters. The agreement is as follows:

Certificate of Formation of a Limited Partnership

State of Washington,
County of King—ss.

We, J. A. Johnson, George Johnson, Albin Johnson, Roy W. Johnson, Lloyd W. Johnson, Winston A. Johnson, Eleanor J. Rector, Evelyn L. Jorgens, Bernice J. Wallin and Elsie Kiel, the subscribers, having formed a limited co-partnership pursuant to the laws of the State of Washington, do hereby certify and state:

I.

That the name of the co-partnership is Western Construction Company.

II.

That the character of the business is general contracting.

III.

That the location of the principal place of business and office is in the Textile Tower, City of Seattle, County of King, and State of Washington.

IV.

That the name and residence of each member, general and limited partners being respectively designated, are as follows:

General Partners

J. A. Johnson, 1619 East 52nd Street, City of Seattle, County of King, State of Washington.

George Johnson, 4558 55th N.E., City of Seattle, County of King, State of Washington.

Albin Johnson, 2003 Boylston North, City of Seattle, County of King, State of Washington.

Limited Partners

Roy W. Johnson, 1520 Olin Place, City of Seattle, County of King, State of Washington.

Lloyd W. Johnson, Winston A. Johnson, 901 East 71st, City of Seattle, County of King, State of Washington.

Eleanor J. Rector, 220 North Portage Path, City of Akron, County of Summit, State of Ohio.

Evelyn L. Jorgens, N. 603 Walnut Road, City of Spokane, County of Spokane, State of Washington.

Bernice J. Wallin, ..., City of Seattle, County of King, State of Washington.

Elsie Kiel, ..., City of Seattle, County of King, State of Washington.

V.

That the term for which the partnership shall exist is for ten (10) years from January 2nd, 1942.

VI.

That the amount of cash contributed by each Limited Partner is as follows: $10,000 each, by each Limited Partner, except Roy W. Johnson, Eleanor J. Rector and Evelyn L. Jorgens who contributed $6,666.66 each.

VII.

The time when the contribution of each Limited Partner is to be returned, is agreed to be the end of said partnership as above stated, to wit, ten (10) years from January 2nd, 1942.

VIII.

The share of proceeds by way of income which each Limited Partner shall receive by reason of his contribution, is as follows: The General Partners, and each of them, are to receive a salary per year, to be fixed by them in a reasonable amount to cover their superintendence and management of the work and business, in proportion to the amount of work done by them, each year, taking into account the amount of the net profit of the partnership each year, never to exceed the sum of $15,000.00 a year salary to any one of the General Partners.

After the payment of said salaries to said General Partners and deduction of all other expenses of the partnership, the net income or proceeds shall

be divided among the partners both general and limited on the basis of their financial interest in said partnership, as shown by the books of the partnership.

IX.

The General Partners are hereby given the right to admit additional Limited Partners in the future upon the agreement of the General Partners hereto, but in no event other than upon a cash contribution to the partnership, and upon the same terms as herein expressed.

X.

The entire management of the partnership shall be vested in the three General Partners and the right is hereby given to the remaining General Partners to continue the business upon the death or retirement of a General Partner, and the right is also given to the General Partners to continue the business upon the death or retirement of any of the Limited Partners hereto.

XI.

It is understood and agreed between all of the partners that a Limited Partner shall not receive out of partnership property any part of his contribution until all liabilities to the General Partners and Limited Partners on account of their contribution, have been paid or their [sic] remains property of the partnership sufficient to pay them.

XII.

The interests of all the Limited Partners herein

may be transferred upon the approval of the General Partners to accept a new assignee as a Limited Partner in this co-partnership, and not otherwise.

XIII.

No General Partner shall demand or receive any property other than cash in return for his contribution and each General Partner's interest in this partnership shall be fixed as of the date of January 2nd, 1942, by the books of the co-partnership.

In Witness Whereof the partners have hereunto set their hands this 24th day of February, 1942.

/s/ J. A. JOHNSON,

/s/ GEO. JOHNSON,

/s/ ALBIN JOHNSON,

/s/ ELEANOR J. RECTOR,

/s/ ROY W. JOHNSON,

/s/ EVELYN L. JORGENS,

/s/ LLOYD W. JOHNSON,

/s/ BERNICE J. WALLIN,

/s/ ELSIE KEIL,

/s/ WINSTON A. JOHNSON.

The partners and their capital accounts were as follows:

	Capital[4]
General Partners:	
Albin Johnson	$15,000.00
George Johnson	15,000.00
J. A. Johnson	15,000.00
Limited Partners:	
Albin's Children:	
Winston Johnson	10,000.00
Elsie Keil	10,000.00
George's Children:	
Bernice Wallin	10,000.00
Lloyd Johnson	10,000.00
J. A.'s Children:	
Roy Johnson	6,666.66
Eleanor Rector	6,666.66
Evelyn Jorgens	6,666.66

The limited partners made their cash capital contributions to the partnership with money they borrowed from their respective fathers. The fathers drew checks on moneys they had to their credit on the books of Western Construction Company and

[4]Through a bookkeeping error the general partners' capital accounts were shown as $15,000 each. This was corrected to $20,000 each on June 30, 1943, when the second limited partnership was formed. Profits for 1942 were distributed on the book basis of 15/105 for each general partner but should have been on the corrected basis of 20/120. In a recomputation under Rule 50 effect should be given the additional profits attributable to the three general partners because of this bookkeeping error.

delivered these checks to their children. In return each child gave his or her promissory note payable to the father. Each limited partner then gave the limited partnership a check in the amount of the loan in payment of his or her limited partnership interest. The partnership itself did not thereby increase its assets; however, each of the general partners had in his possession $20,000 worth of notes signed by his children. These notes were never pledged as collateral for any loan but they were listed as personal assets of the general partners in applications for construction bonds. On July 30, 1942, an additional $50,000 was borrowed from the bank.

Each of the children knew and understood he was signing a note which was unconditionally payable and which represented a bona fide obligation on his part. They did not take on these obligations lightly as there was considerable discussion about the notes before signing them. While none of the husbands of the Johnson daughters signed any of these notes given to the general partners, generally speaking the notes were signed by the wives with the knowledge and consent of their husbands. Rachel Gustafson, the daughter of George Johnson, was invited to participate in the first limited partnership. However, she declined to do so as both she and her husband did not desire to sign a note for $5,000. They knew that the construction business is subject to heavy losses, as well as handsome profits. Rachel had seen first-hand the Coulee Dam fiasco with its resulting damaging effects to the

partnership. Her husband had changed his course of study at the University from premedical to engineering at the urging of his father-in-law. When he graduated there was no work available in engineering so he entered the meat business and at present is the owner of a butcher shop.

These notes did not provide that they were payable solely from business profits but, on the contrary, there was a general understanding among the limited partners that they were entering a normal business transaction upon the signing of the notes. The financial situation of the limited partners of the 1942 partnership was good, and each had sufficient assets to cover his or her liability on the notes. This was especially true of the three sons of the respective general partners. Two of the sons had already achieved considerable prominence and success in the business world. Though the sons-in-law did not sign the notes, they treated these obligations as resting on their community property. An example of all the notes which were given by the limited partners to their fathers is the note of Eleanor J. Rector given to her father, J. A. Johnson. It reads as follows:

$6,666.66 Seattle, Wash. April 21st, 1942

One year after date, without grace, for value received I promise to pay to the order of J. A. Johnson Six Thousand Six Hundred Sixty-six Dollars and Sixty-seven Cents, in Lawful Money of the United States of America, of the present standard value, with interest thereon in like Lawful Money,

at the rate of 4 per cent per annum from date until paid. Interest to be paid at maturity and if not so paid, the whole sum of both principal and interest to become immediately due and collectible at the option of the holder of this note. And in case suit or action is instituted to collect this note or any portion thereof I promise and agree to pay in addition to the costs and disbursements provided by statute such sum as the court may adjudge reasonable as attorney's fees in said suit.

Due April 21st, 1943.

/s/ ELEANOR J. RECTOR.

On June 30, 1943, a new limited partnership was formed on substantially the same basis as the former one, excepting that three additional daughters were brought into the partnership as limited partners. The additional limited partners consisted of Rachel Gustafson and Betty Lorraine Ellingson, daughters of George Johnson, and Vedola Johnson (now Mrs. Vedola Kent), daughter of Albin Johnson. The capital of the general partners remained at $20,000 each. The capital of the limited partners was changed by consent of all parties as follows:

	Capital
Albin's children:	
Winston Johnson	$6,666.66
Elsie Keil	6,666.66
Vedola Johnson	6,666.66

	Capital
George's children:	
Bernice Wallin	$5,000.00
Lloyd Johnson	5,000.00
Betty Ellingson	5,000.00
Rachel Gustafson	5,000.00
J. A.'s children:	
Roy Johnson	6,666.66
Eleanor Rector	6,666.66
Evelyn Jorgens	6,666.66

None of the new partners made a direct contribution of capital to the partnership. Rachel Gustafson and Betty Lorraine Ellingson each obtained a division of the interests which had been held in the names of their sister and brother, Bernice Wallin and Lloyd Johnson. This was accomplished by the unpaid notes of the latter partners being returned to them by their father and new notes in the amount of $5,000 being given by each of the four children to their father. Vedola Johnson (daughter of Albin) was taken in as a limited partner in the same way as Rachel Gustafson and Betty Lorraine Ellingson, daughters of George, were taken in. She executed her note for $6,666.66 payable to her father. Her brother Winston and her sister Elsie Keil had their notes for $10,000 each returned to them and they each executed their note for $6,666.66 payable to their father. When these new limited partners found that their brothers and sisters had done so well in the 1942 partnership they too wanted to acquire an interest for them-

selves. The interests of the three Johnson families were always kept equal in the various partnerships. The moneys which these adult children borrowed from their fathers and used to invest in the limited partnership were bona fide loans. The general partners had minor children but they were not taken into the partnership because they wanted notes from adults, fully responsible for payment. The notes were negotiable, bore interest, and were all for short terms not exceeding two years, except the first two notes of Lloyd Johnson and his sister Bernice Wallin to their father George Johnson for $10,000 each. These notes were installment notes, payable in yearly installments of not less than $3,500 in any one payment. Some of the notes given by the limited partners were paid in 1945. Lloyd paid his note in 1946, Winston and Elsie paid their notes in 1947. Rachel has not paid her note as no demand has been made for payment from her by her father.

The limited partnerships were very successful and made large net profits which were credited each year to the partners on the basis of their capital accounts. In determining net profits there was first subtracted $15,000 for each general partner as salary. The 1942 profits were several times more than the expectations of the general partners, and the crediting of profits to each partner was more than three and one-half times his capital account; however, the construction business represents a hazardous financial risk and it is possible to lose heavily, as well as realize large profits.

The partnership reported its profits for tax purposes upon a completed contract basis. This was true of the Quartermaster and Rainier Vista contracts which were under way by the time the first partnership was created. Gross profits were realized upon the Quartermaster and Rainier Vista contracts in the respective amounts of $234,866.20 and $201,754.39 which were reflected in the 1942 return of the limited partnership. Division of such profits was made with the limited partners on the basis of their stated partnership interests.

The limited partnership was not the result of an impulse set off by the desire to minimize taxes, but rather the result of many years of thought by the general partners who were anxious to have their sons, daughters, and sons-in-law come into the business so that it would continue after the general partners retired or died. Just prior to the formation of the partnership it appeared that Lloyd and Roy were drifting away from the business to other attractive jobs. Their talents and training were in demand by others. For some years prior to 1942 Lloyd had worked for various individuals and companies other than Western Construction Company. In 1941 Lloyd, contrary to his father's wishes, formed a construction partnership with Max J. Kuney of Spokane, Washington, in which each had a one-half interest. When the Kuney-Johnson partnership was formed there was no plan for its being a permanent association, but that partnership opened offices in Seattle, Washington, and has been successfully active in the construction business

from that time down to the present. Lloyd did not work as an employee of the limited partnership but he did perform important services for the firm. He was a graduate engineer with a great deal of experience. In 1942 and 1943 he was consulted by the general partners on matters relating to pricing and estimating pricing jobs, figuring bids and helping them get scarce materials such as nails which were almost impossible to get. Pricing was a very important work during the war years because prices changed so fast. The partners telephoned Lloyd a great deal on business matters of the company. He also did a great deal of night work helping the general partners on matters relating to engineering, bids and estimates. He did not receive any compensation for this work but he devoted a considerable amount of his time because of his interest as a limited partner. It was of great value to the partnership.

Roy Johnson was engaged for many years prior to 1942 in businesses other than the Western Construction Company. He rendered no regular services to the limited partnership until January, 1943, when he devoted full time to its affairs. In 1942 he assisted the partnership by advising it on estimates and by performing engineering work for it. From January, 1943, until June, 1944, Roy worked full time for the partnership and was paid a salary of $2.05 an hour. During this period he worked as an engineer designing layout foundations, excavating footings, roads, buildings, arches, and super-

intending both large and small jobs. He estimated various projects and did some difficult engineering work which the general partners could not do. In June, 1944, Roy went to Alaska to assist with a hydroelectric project. He remained there until the fall of 1947, working on this project which had no connection with the Western Construction Company.

Winston Johnson, son of Albin Johnson, worked for the partnership at all times after March, 1942, when he was released from the Army. Winston, who had three years of college training as a civil engineer, did various types of work for the firm. He worked in the office, estimated jobs, obtained materials, arranged subcontracts, represented the partnership before the Navy on problems relating to contracts, and supervised jobs. His pay for this work was $80 or $90 a week which was somewhat below the standard for estimators, some of whom earned $30,000 a year working on a salary plus bonus basis.

The daughters did not render any services to the limited partnership of any substantial consequence.

With the exception of Harold Ellingson, Betty's husband, none of the sons-in-law worked for the limited partnership and Ellingson worked as a carpenter for only three months of the taxable years here involved. The general partners hoped that some day most of the sons-in-law would be associated with the partnership.

The partnership profits were regarded by all of the limited partners and their spouses as community

property and in the filing of their returns for the years 1942 to 1945, inclusive, such profits were divided in the returns of the spouses on a community property basis the same as other income. Substantially all of the returns of the limited partners and their spouses for the years 1942 to 1945, inclusive, were prepared at the office of the Western Construction Company by the accountant who handled the affairs of the partnership.

Partnership checks representing distribution of profits were sometimes made out to the limited partners and sometimes to the spouses of the limited partners, depending upon which one requested the money. It was regarded as a family business and no distinction was made as between limited partners or his or her spouse when it came to distributing the profits. There were no profits credited to the accounts of the limited partners and no withdrawals by them until after the close of the taxable year ended December 31, 1942. The limited partners were entitled to withdraw their share of the profits as they pleased and the share of the profits credited to the individual partner's accounts were in no way considered to be anything but their own property. No limited partners ever withdrew any profits and turned them over in any way to the father, the general partner. No limited partner was in any way dependent upon his or her father, the general partner, for support either at the time of the formation of the partnership or later.

The freedom of withdrawals by the limited partners without consulting the general partners is

illustrated by the various uses they made of their profits. Roy Johnson in 1945 withdrew $40,000 to invest in his own construction project in Alaska. At one time he overdrew $6,600 for working capital in his Alaskan project which he returned when the bookkeeper notified him of that fact. Winston Johnson withdrew $2,333.50 to pay for an engagement ring, the cost of his honeymoon, his mother's funeral expenses, and personal items. He also withdrew $2,700 to purchase a lot for his home and later $36,509.79 to invest in the stock of another corporation. Lloyd Johnson withdrew $9,000 of his profits to invest in a restaurant. The greater portion of his withdrawals were for uses other than the payment of income taxes. Elsie Keil used some of her profits to pay personal bills and also withdrew $45,976.52 to buy stock in another corporation. Vedola Johnson withdrew $6,586 of her profits to purchase stock in another corporation. Evelyn Jorgens invested $8,500 of her profits in a chicken ranch. Rachel Gustafson only made withdrawals to pay income taxes as she had no other need for the money. Bernice Wallin withdrew $5,000 of her profits to invest in a real estate business and made a number of other personal withdrawals. Betty Ellingson used some of her profits for personal expenses.

The three general partners managed the limited partnership in the same manner that they had the business which preceded the limited partnership. As general partners, the management and direction

of the business was in their hands and all their personal assets, including the notes of the limited partners, were subject to possible loss in the event the limited partnership failed. The sons who were limited partners worked under the direction of the general partners. Only the general partners could sign checks or notes for Western Construction Company.

There was no delegation of authority by the limited partners to the general partners. The limited partners held no meetings regarding such delegation of authority, elected no officers and representatives and received no certificates or other evidence of their contribution as limited partners, other than the partnership articles.

The limited partnerships were not operated with any of the usual formalities of a corporation or association. There were no officers, no regular or formal meetings, no by-laws, board of directors, seal or minute books. The Western Construction Company held itself out to the public as a true limited partnership. The parties to the limited partnership agreements here involved formed a bona fide partnership and really and truly intended to join together for the purpose of carrying on the business as a partnership. It was not an association taxable as a corporation. Proper statutory notice of the formation of both limited partnerships was given. The limited partnership agreements provided that the general partners could admit additional limited partners and continue the business upon the death or retirement of a general or limited

partner. Those rights could be exercised only by agreement among the general partners.

It was orally stipulated at the hearing that Lloyd Johnson and his wife, Roberta Johnson (petitioners herein), are entitled to additional community expense deductions over those allowed in the deficiency notice issued to them for the years and in the amounts as follows:

Year	Amount
1942	$1,200
1943	1,200
1944	1,200
1945	600

Opinion

Black, Judge:

There are two issues presented in these proceedings, however, they are in the alternative. The first issue is whether petitioner Western Construction Company is an association taxable as a corporation. If it is held that Western Construction Company is not taxable as a corporation but is instead a partnership, then we must decide the second issue, namely, the composition of the partnership for tax purposes. The respondent concedes that he has made inconsistent determinations in determining that Western Construction Company was an association taxable as a corporation and then also determining that the same business during the same period was a general partnership composed of three members. He concedes that both determinations cannot stand.

Issue 1. Respondent first contends that petitioner Western Construction Company resembles an association in corporate form and is, therefore, taxable as a corporation.[5] Morrissey v. Commissioner, 296 U. S. 344 is cited by respondent as the basic authority for taxing Western Construction Company as a corporation, but petitioners also rely upon the Morrissey case to sustain their argument that Western Construction Company is taxable as a partnership. In the Morrissey case the Court said: "The inclusion of associations with corporations implies resemblance; but it is resemblance and not identity." Therefore, it is for us to determine whether Western Construction resembles a corporation to a sufficient extent as to make it taxable as such.

Petitioner Western Construction Company was created as a limited partnership under the laws of the State of Washington, the pertinent sections of which are printed in the margin.[6] This designation

[5]See footnotes 2 and 3, supra.

[6]Remington's Revised Statutes of Washington, Annotated, Volume Ten.

§9966. Limited partnership may be formed. Limited partnership for the transaction of mercantile, mechanical, or manufacturing business may be formed within this state, by two or more persons, upon the terms and subject to the conditions contained in this chapter.

§9967. Of whom composed, and liability of members. A limited partnership may consist of two or more persons, who are known and called general partners, and are jointly liable as general partners now are by law, and of two or more persons who shall contribute to the common stock a specific sum

as a partnership is not conclusive of its being such for tax purposes. To ascertain whether Western Construction Company is taxable as a corporation or a partnership it is necessary to find what the rights and duties of the partners are as between

in actual money as capital, and are known and called special partners, and are not personally liable for any of the debts of the partnership, except as in this chapter specially provided.

§9968. * * *

§9969. * * *

§9970. Renewal of limited partnership. A limited partnership may be continued or renewed by making, acknowledging, filing, and publishing a certificate thereof, in the manner provided in this chapter for the formation of such partnership originally, and every such partnership, not renewed or continued as herein provided, from and after the expiration thereof according to the original certificate, shall be a general partnership.

§9971. * * *

§9972. * * *

§9973. Suits by and against limited partnership—Parties. All actions, suits, or proceedings respecting the business of such partnership shall be prosecuted by and against the general partners only, except in those cases where special partners or partnerships are to be deemed general partners or partnerships, in which case all the partners deemed general partners may join therein; and excepting also those cases where special partners are severally liable on account of sums or amounts received or withdrawn from the capital stock, as provided in the last preceding section.

§9974. Dissolution, how may be accomplished. No dissolution of a limited partnership shall take place, except by operation of law, before the time specified in the certificate of partnership, unless a notice of such dissolution, subscribed by the general

themselves and the public. Therefore, we must examine the statutes of the State of Washington by virtue of which Western Construction Company exists as a limited partnership in Washington, and the certificate of the formation of the partnership filed with the county auditor.

The certificate of formation of the limited partnership[7] reserves the following powers: the duration of the partnership is 10 years;[8] the general partners are given the right to admit additional limited partners upon the same terms expressed in this certificate;[9] the management is vested in the general partners;[10] the remaining general partners are given the right to continue the business upon the death or retirement of a general or limited partner;[11] the interest of a limited partner is transferable only

and special partners, is filed with the original certificate of partnership, or the certificate, if any, renewing or continuing such partnership, nor unless a copy of such notice be published for the time and in the manner prescribed for the publication of the certificate of partnership.

§9975. Liabilities and rights of members of firm. In all cases not otherwise provided for in this chapter, all the members of limited partnerships shall be subject to all the liabilities and entitled to all the rights of general partners.

[7]Findings of fact, page 9, supra.

[8]Id. Article V and VII.

[9]Id. Article IX.

[10]Id. Article X.

[11]Id. Article X.

with the approval of the general partners;[12] and no general partner may demand or receive any property other than cash in return for his contribution.[13]

We think that the case of Glensder Textile Co., 46 B.T.A. 176, is indistinguishable from the instant proceedings except that Glensder Textile Co. was a limited partnership formed under the Uniform Limited Partnership Act of the State of New York, whereas the limited partnership here was organized under the laws of the State of Washington. There seems to be no substantial difference between the two statutes. In the Glensder Textile Co. case we held that the limited partnership did not resemble a corporation, but was more closely akin to a general partnership. See also J. A. Riggs Tractor Co., 6 T.C. 889; George Brothers & Co., 41 B.T.A. 287. In the Glensder Textile Co. case, after discussing in considerable detail the several provisions of the limited partnership agreement there present and which were similar in character to those of the limited partnership agreement in the instant case, we said:

> We must conclude, therefore, after an examination of the organization and legal powers and liabilities of the members of the limited partnership before us, that it does not bear such a resemblance to an association or operate effectively as such so as to justify our inclusion of it in that category for tax purposes. Although

[12]Id. Article XII.

[13]Id. Article XIII.

> a limited partnership, it was still a partnership, and should be treated as such under the statute. The statute provides a category for individuals doing business in partnership and deriving income thus; and we may not disregard it where the likeness to an association is no plainer than it is here.

In the Glensder Textile Co. case we set out in the margin the applicable statute and the Treasury regulations with reference to limited partnerships. They are also set out in our footnotes 2 and 3 herein and it is unnecessary to reprint them here. Following our decision in that case, we hold that petitioner Western Construction Company was not an association taxable as a corporation. On this issue petitioner is sustained.

Issue 2. As we have held that Western Construction Company is a partnership for tax purposes, we must now determine the composition of that partnership.

Respondent contends that if Western Construction Company is held to be a partnership for Federal tax purposes, it consists solely of the three general partners. Petitioners contend that Western Construction Company is a partnership for tax purposes and includes all the limited partners. Both parties cite the cases of Commissioner v. Tower, 327 U. S. 280 and Lusthaus v. Commissioner, 327 U. S. 293. Since the hearing of these proceedings and the filing of briefs, the Supreme Court has decided the case of Commissioner v. Culbertson, 337 U. S. 733. From these cases it is apparent that in order to determine the issue it is necessary for us to find whether West-

ern Construction Company is a bone fide business partnership and upon such finding the tax consequences rest.

Respondent argues that the formal documents executed in 1942 and 1943 creating a limited partnership under the laws of the State of Washington are nothing more than a reallocation of the income attributable to the general partners, and that there was no real intent to create a partnership for business purposes. Petitioners argue that the partnership is a result of a bona fide intent of the general and limited partners to join together for the purposes of carrying on the construction business and to share in the profits and losses. Their intention in this respect is a question of fact to be determined from the agreement and by their conduct in its execution and in the subsequent operation of the business. As was said in Commissioner v. Culbertson, supra:

> * * * The question is not whether the services or capital contributed by a partner are of sufficient importance to meet some objective standard supposedly established by the Tower case, but whether, considering all the facts—the agreement, the conduct of the parties in execution of its provisions, their statements, the testimony of disinterested persons, the relationship of the parties, their respective abilities and capital contributions, the actual control of income and the purposes for which it is used, and any other facts throwing light on their true intent—the parties in good faith and acting with a business purpose intended to join to-

gether in the present conduct of the enterprise. * * *

At this juncture it seems appropriate to point out that the Commissioner himself in his determination of the deficiencies against Western Construction Company has determined that Western Construction Company should be recognized as a bona fide organization in which the members of it joined together for a business purpose. He contends. however, that the organization should be treated as an association taxable as a corporation and not as a limited partnership. That is his first and main contention. Failing in that, he contends in the alternative that the partnership should be held a general partnership with no recognition given to the limited partners.

The record shows that prior to the formation of the limited partnership the general partners were having difficulty in getting the larger and more lucrative government contracts because of their inadequate financial backing. This lack of capital made it extremely difficult to get the necessary construction bonds. To obviate this difficulty, the partners attempted to get outside capital but were unsuccessful, and the one time a joint venture was attempted to obtain the necessary bond Western Construction Company came out on the short end of the bargain. In bringing in the children as limited partners, $60,000 was added to the individual assets of the general partners by reason of the personal notes given by the children to their respective fathers. This was a factor of considerable impor-

tance to the financial status of the general partners and, through them, to the limited partnership.

The evidence convinces us that these notes were not given as a part of a scheme to avoid taxes but were given to increase the financial strength of the partnership. Cf. O. H. Delchamps, 13 T. C. 281. In the Delchamps case, two brothers and their sister, equal partners in a chain grocery business, admitted the brothers' wives as partners, each brother contributing two-fifths of his interest to his wife and the sister a one-fifth of her interest to each wife. The admission of the wives as partners was necessary for the purpose of securing bank credit for the business. Under these circumstances we held that the partnership was formed for a valid business purpose with a bona fide intention to form a business partnership. We think the Delchamps case supports the validity of the partnership agreement here involved. It is true that these notes were never used as collateral by the partnership, but shortly after its formation the limited partnership borrowed an additional $50,000 from the bank and the notes were listed with the bonding companies as a part of the personal assets of the general partners. There was no plan whereby these notes would be payable only out of profits—it was a business transaction in which the adult children participated with full knowledge of the attending responsibilities in signing these notes, and with the consent of the sons-in-law.

Profits were distributed as in any normal partnership and the limited partners had the right to withdraw their shares of the profits at any time and use them for whatever they might desire. The ma-

jority of the limited partners did not withdraw a great deal of their profits; however, they had the right to do so and some of the limited partners withdrew a considerable portion of their distributive shares and used the funds as they saw fit. Cf. John A. Morris, 13 T. C. .., promulgated December 21, 1949. The Morris case involved a limited partnership organized under the laws of the State of New York, as was the limited partnership in Glensder Textile Co. case, supra. In the Morris case we held that Edna B. Morris, wife of the taxpayer John A. Morris, was a partner in the limited partnership there involved even though the capital which she contributed to the partnership came from a prior gift which she received from her husband and even though she did not render any services nor did she ever participate in the management of the business. We based our holding that she was a limited partner on a finding which we made from the evidence that "Petitioner, his wife, and the other members of the brokerage firm formed a bona fide partnership and really and truly intended to join together for the purpose of carrying on the business as a partnership." We relied as our chief authority for the holding upon Commissioner v. Culbertson, supra.

We think that the evidence shows that the three Johnson brothers had a real desire to have their children become partners in the Western Construction Company. The sons not only gave their notes, but also contributed their engineering skill which the general partners lacked. Their services were of substantial value to the partnership. All of the limited

partners were conscious of the fact that the partnership was real and the promissory notes given their respective fathers were binding obligations.

Looking at the evidence as a whole, we think that petitioner Western Construction Company was intended and created as a valid business partnership including all the limited partners and must, therefore, be recognized as such for tax purposes. John A. Morris, supra.

The parties have stipulated that each of the three general partners expended $1,200 "for each of the years 1942, 1943, and 1944 in excess of that determined and allowed by respondent in the deficiency notices, as business expenses, covering depreciation, insurance and operating expenses of automobiles, and also entertainment and travel expenses." From the stipulation it is apparent that a total of $3,600 for each of these years was expended as additional ordinary and necessary expenses of the business. These expenses are not allowable as a deduction from the personal returns of the general partners as they are partnership expenses and are so deductible. Hiram C. Wilson, 17 B. T. A. 976. In a recomputation under Rule 50 these expenses should be deducted in computing partnership net income for each of the years 1942, 1943 and 1944.

Reviewed by the Court.

Decisions will be entered under Rule 50.

Turner, J., dissents.

Opper, J., dissenting:

The two issues before us cannot be neatly severed, so that we can separately deal with the reality of the partnership and its resemblance to a corporation. For the first time since Tower, Lusthaus and Culbertson, this case raises the question whether a family enterprise cast in the form of a limited partnership, just because it truly represents an actual form of doing business, is not in reality more nearly like a corporation than any other business organism. The very aspects upon which petitioners rely to strengthen their claim of a valid partnership and yet to explain the relation to the business of the "limited partners" are in fact and in essence the Morrissey[1] type of corporate characteristics.[2]

In Glensder Textile Co., 46 B. T. A. 176, decided before Tower and Lusthaus, the Board was not confronted by the juxtaposition of a developed family partnership rule with the similarity of limited family partnerships to corporations, and hence it cannot be regarded as controlling this question. It is for that reason, at least, less persuasive than a more recent decision of this Court holding certain family limited partnerships to be taxable as

[1]See footnote 4.

[2]"* * * namely, centralized control and management, limited liability, transferability of interests, title to property held in the name of the business entity, continuity of enterprise, and sustained operation of the business for profit. * * *" (Giant Auto Parts, Ltd., 13 T. C. 307, 315.)

corporations.[3] Giant Auto Parts, Ltd., 13 T. C. 307.

Without placing undue reliance on relevant provisions of local law, it cannot altogether lack significance that the Constitution of the State of Washington in the article referring to "corporations" provides that: "All laws relating to corporations may be altered, amended, or repealed by the legislature at any time, and all corporations doing business in this State may, as to such business, be regulated, limited, or restrained by law," Article 12, section 1; that "the term 'corporations,' as used in this article shall be construed to include all associations and joint stock companies having any powers or privileges of corporations not possessed by individuals or partnerships * * *," Article 12, section 5; and that the Supreme Court of the State has declared that "Under constitutional provisions similar to Section 5, article 12 supra, it is almost uniformly held that joint-stock companies and limited partnerships organized under statutory authority are in fact corporations." State ex rel. Range, et al., v. Hinkle, 126 Wash. 581, 219 Pac. 41, 42. (Emphasis added.)

[3] "It is true that the ownership of the business was confined to a few members of an intimate family group, that no regular or formal meetings were held, that no minutes were kept, and that no election of officers was held after the original execution of the partnership agreement. The petitioner's failure to observe the formalities in respect to meetings and elections and the fact that it was owned by a small number of persons have no bearing upon its classification as a corporation or partnership. * * *" (Giant Auto Parts, Ltd., supra.)

And while nomenclature is not, of course, decisive, it may nevertheless be added that the Washington statutes under which petitioner "company" was formed refer to the capital of the enterprise as "common stock" and "capital stock," and that in one instance it is provided: "* * * no part of the capital stock thereof shall be withdrawn, nor any division of interests be made, so as to reduce such capital stock below the sum stated in the certificate of partnership * * *." Remington's Revised Statutes, Washington, Vol. 10, sections 9967, 9972. In fact, if the general partners are thought of as common stockholders, and the special partners as holders of participating preferred stock, the entire arrangement would be identical in all respects with a corporate structure, except for the unlimited liability of the general partners. Since it is similarity and not identity which constitutes the test, Morrissey v. Commissioner,[4] and since it is the

[4]296 U. S. 344:

"The inclusion of associations with corporations implies resemblance; but it is resemblance and not identity. * * * Thus an association may not have 'directors' or 'officers,' but the 'trustees' may function 'in much the same manner as the directors in a corporation' for the purpose of carrying on the enterprise. The regulatory provisions of the trust instrument may take the place of 'by-laws.' And * * * it cannot be considered to be essential to the existence of an association that those beneficially interested should hold meetings or elect their representatives. Again * * * the test of an association is not to be found in the mere formal evidence of interests or in a particular method of transfer.

* * *

"It is no answer to say that these advantages flow

interest of the special partners, and not that of the general partners, which raises the real present issue on both alternative contentions, it seems to me inescapable that this arrangement fails on the one hand to bear any resemblance to a true and actual partnership of all the participants, see Hill, Judge, dissenting in John A. Morris, 13 T. C., ... (Dec. 21, 1949), but that on the other, it does resemble and almost duplicates a corporation, and that reality thus requires the tax to be imposed upon it as a corporation and not as a partnership.

Leech, Hill, Disney, Harron, and LeMire, JJ., agree with this dissent.

Served March 23, 1950.

from the very nature of trusts [here limited] partnerships. * * * The suggestion ignores the postulate that we are considering those trusts [family partnerships] which have the distinctive feature of being created to enable the participants to carry on a business and divide the gains which accrue from their common undertaking, trusts that thus satisfy the primary conception of association and have the attributes to which we have referred, distinguishing them from [ordinary] partnerships. In such a case, we think that these attributes make the trust sufficiently analogous to corporate organization to justify the conclusion that Congress intended that the income of the enterprise should be taxed in the same manner as that of corporations." (Emphasis and bracketed language added.)

[Title of Tax Court and Cause.]

Docket Nos. 15495, 15496, 15497, 15498, 15499, 15500

CLERK'S CERTIFICATE

I, Victor S. Mersch, Clerk of The Tax Court of the United States, do hereby certify that the foregoing documents, 1 to 95 inclusive, constitute and are all of the original papers and proceedings, except Exhibits 1 thru 28 and A thru BB, (Exhibit 29, marked for identification only and not of record) on file in my office as the original and complete record in the proceedings before The Tax Court of the United States in the above cases, entitled: "Commissioner of Internal Revenue, Petitioner, v. Western Construction Company, Albin Johnson, Ellen M. Johnson, Huldah Johnson, George J. Johnson, J. A. Johnson, Respondents," Dkt. Nos. 15495 thru 15500, respectively, and in which the respondents in The Tax Court proceedings have initiated appeals as above numbered and entitled together with a true copy of the docket entries in said Tax Court proceedings, as the same appear in the official docket book in my office. The exhibits are separately certified.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 27th day of December, 1950.

[Seal] /s/ VICTOR S. MERSCH,
Clerk.

[Endorsed]: No. 12806. United States Court of Appeals for the Ninth Circuit. Commissioner of Internal Revenue, Petitioner, vs. Western Construction Company, Respondent. Commissioner of Internal Revenue, Petitioner, vs. Albin Johnson, Respondent. Commissioner of Internal Revenue, Petitioner, vs. Ellen M. Johnson, Respondent. Commissioner of Internal Revenue, Petitioner, vs. Huldah Johnson, Respondent. Commissioner of Internal Revenue, Petitioner, vs. George J. Johnson, Respondent. Commissioner of Internal Revenue, Petitioner, vs. J. A. Johnson, Respondent. Transcript of the Record. Petitions to Review Decisions of the Tax Court of the United States.

Filed: January 3, 1951.

/s/ PAUL P. O'BRIEN,

Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 12,806

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

WESTERN CONSTRUCTION COMPANY, ALBIN JOHNSON, ELLEN M. JOHNSON, HULDAH M. JOHNSON, GEORGE J. JOHNSON, J. A. JOHNSON,
Respondents.

MOTION TO BE RELIEVED FROM PRINTING OR REPRODUCING CERTAIN EXHIBITS

Comes now the Commissioner of Internal Revenue, petitioner above named, by his attorney, Theron Lamar Caudle, Assistant Attorney General, and respectfully applies to and moves this Court for an order providing that the following exhibits need not be printed or otherwise reproduced in the printed record on review, namely, Petitioners' Exhibits 2, 4-11, inclusive, 17, 19, 24 and 25; Respondents' Exhibits A, B, D-G, inclusive, and I-BB, inclusive, but that said exhibits may be referred to by counsel in their respective briefs and on oral argument, or reproduced, in whole or in part, in their respective briefs, and considered by the Court with the same force and effect as if included in the printed record on review.

It is further stated that the original of the said

exhibits above mentioned have been forwarded to the Clerk of this Court by the Tax Court and have been filed in this Court in the above-entitled case as part of the record, and are available for examination by the Court.

This application is based upon the ground that the aforesaid exhibits are voluminous and include numerous tax returns, and cannot readily be printed without excessive and disproportionate cost, and are, in any event, available to this Court as aforesaid, and on file in original form.

January . ., 1951.

/s/ THERON LAMAR CAUDLE,
Assistant Attorney General,
Attorney for Petitioner.

To: Ralph B. Potts, Esquire, 1702 Hoge Building, Seattle 4, Washington, Attorney for Respondents.

So ordered:

/s/ WILLIAM DENMAN,

/s/ H. T. BONE,

/s/ WALTER L. POPE,
Judges, U. S. Court of Appeals for the Ninth Circuit.

Certificate of Service attached.

[Endorsed]: Filed U.S.C.A. January 18, 1951.

[Title of Court of Appeals and Cause.]

Docket Nos. 15495, 15496, 15497,
15498, 15499 and 15500

STATEMENT RE DIMINUTION OF RECORD

To the Clerk of The Tax Court of the United States:

Pursuant to the provisions of Rule 75(o) of the Federal Rules of Civil Procedure adopted by the United States Court of Appeals for the Ninth Circuit, you are hereby notified that the petitioner on review will not exclude or omit any part of the record in this proceeding.

/s/ THERON L. CAUDLE, C.A.R.
Assistant Attorney General.

/s/ CHARLES OLIPHANT, C.A.R.
Chief Counsel, Bureau of Internal Revenue, Attorneys for Petitioner on Review.

Statement of Service attached.

Received and filed T.C.U.S. December 21, 1950.

No. 12,806

In the United States Court of Appeals for the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

WESTERN CONSTRUCTION COMPANY, RESPONDENT

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ALBIN JOHNSON, RESPONDENT

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ELLEN M. JOHNSON, RESPONDENT

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

HULDAH JOHNSON, RESPONDENT

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

GEORGE J. JOHNSON, RESPONDENT

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

J. A. JOHNSON, RESPONDENT

ON PETITIONS FOR REVIEW OF THE DECISIONS OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE PETITIONER

THERON LAMAR CAUDLE,
Assistant Attorney General.
ELLIS N. SLACK,
HELEN GOODNER,
L. HENRY KUTZ,
Special Assistants to the Attorney General.

FILED

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In the United States Court of Appeals for the Ninth Circuit

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ON PETITIONS FOR REVIEW OF THE DECISIONS OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE PETITIONER

OPINION BELOW

The only previous opinion (R. 655-696) is the opinion of the Tax Court, *en banc,* seven judges dissenting, which is reported in 14 T.C. 453.

JURISDICTION

The above entitled six cases were heard together in the Tax Court and a single opinion was rendered. The petition for review in the case of taxpayer Western Construction Company involves federal income, declared value excess profits and excess profits taxes for the four years 1942 through 1945, inclusive. The other five cases each involve federal income taxes for the three years 1943 through 1945, inclusive.

The Commissioner of Internal Revenue mailed to taxpayer Western Construction Company a notice of deficiency in income, declared value excess profits and excess profits taxes on May 29, 1947, in the respective amounts and for the respective years below stated as follows (R. 6, 11-22, 656):

Taxpayer	Year	Kind of Tax	Deficiency
Western Construction Company	1942	Income	$ 4,085.00
		Declared Value Excess Profits	49,390.07
		Excess Profits	255,736.68
	1943	Income	4,703.95
		Declared Value Excess Profits	43,432.61
		Excess Profits	223,777.92
	1944	Income	3,152.71
		Declared Value Excess Profits	6,677.60
		Excess Profits	27,574.04
	1945	Income	4,401.33
		Declared Value Excess Profits	18,253.17
		Excess Profits	87,647.08

The Commissioner of Internal Revenue mailed on May 29, 1947, to each of the remaining five taxpayers a notice of deficiency in income tax in the respective

amounts below stated for the years 1943, 1944, and 1945, as follows:

Taxpayer	Year	Amount of Deficiency	Record References
Albin Johnson	1943	$93,780.81	(R. 44, 52–62, 656.)
	1944	6,717.05	
	1945	23,177.99	
Ellen M. Johnson	1943	29,624.73	(R. 78, 84–93, 656.)
	1944	2,312.86	
	1945	6,529.81	
Huldah Johnson	1943	30,745.52	(R. 109, 115–124, 656.)
	1944	2,385.74	
	1945	6,681.15	
George J. Johnson	1943	29,872.23	(R. 140, 146–155, 656.)
	1944	2,320.75	
	1945	6,635.52	
J. A. Johnson	1943	29,111.03	(R. 171, 176–185, 657.)
	1944	2,262.40	
	1945	6,529.81	

Within ninety days thereafter and in each case on August 11, 1947, each of the above entitled six taxpayers filed a petition with the Tax Court for redetermination of the deficiencies above stated under the provisions of Section 272 of the Internal Revenue Code, as follows:

Taxpayer	Record References
Western Construction Company	(R. 3, 22.)
Albin Johnson	(R. 41, 62.)
Ellen M. Johnson	(R. 75, 93.)
Huldah Johnson	(R. 106, 124.)
George J. Johnson	(R. 137, 155.)
J. A. Johnson	(R. 167, 185.)

The final order and decision of the Tax Court was entered in the case of taxpayer Western Construction Company on July 14, 1950, determining that there are no deficiencies in income tax, declared value excess profits tax, and excess profits tax for the calendar years 1942, 1943, 1944 and 1945. (R. 35-36.)

The final order and decision of the Tax Court was entered in the case of each of the other five taxpayers on

July 14, 1950, determining that there is a deficiency or overpayment in income taxes on the part of each of the taxpayers below listed for the calendar years and amounts respectively below stated:

Taxpayer	Year	Amount of Deficiency Determination	Amount of overpayment Determination	Record References
Albin Johnson.....	1943	$9,311.96		(R. 68.)
	1944	834.40		
	1945	2,667.06		
Ellen M. Johnson.....	1943	3,348.71		(R. 99–100.)
	1944	357.89		
	1945		$232.81	
Huldah Johnson.....	1943	3,650.23		(R. 130.)
	1944	339.85		
	1945		228.79	
George J. Johnson.....	1943	2,815.43		(R. 161.)
	1944	322.38		
	1945		216.54	
J. A. Johnson.....	1943	2,886.91		(R. 191.)
	1944	357.89		
	1945		232.81	

The cases were brought to this Court by petitions for review filed by the Commissioner of Internal Revenue, in the case of each taxpayer, respectively, on October 9, 1950:

Taxpayer	Record References
Western Construction Company	(R. 37–39.)
Albin Johnson	(R. 69–72.)
Ellen M. Johnson	(R. 100–103.)
Huldah Johnson	(R. 131–134.)
George J. Johnson	(R. 162–165.)
J. A. Johnson	(R. 192–195.)

within three months after the Tax Court's decision was rendered, pursuant to the provisions of Section 1141 (a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948, and Section 1142 of the Internal Revenue Code. In the case of taxpayer Western Construction Company by stipulation in writing the Commissioner and the taxpayer, pursuant

to the provisions of Section 1141 (b) (2) of the Internal Revenue Code, designated that the decision of the Tax Court of the United States be reviewed by this Court. (R. 36.)

QUESTIONS PRESENTED

1. Whether the limited partnership, Western Construction Company, constituted an association taxable as a corporation.

2. In the alternative, if Western Construction Company is held not to be taxable as a corporation, then whether Western Construction Company was a partnership consisting only of the three general partners or, on the other hand, whether the Tax Court properly recognized the children of the three general partners as members of the firm, in addition to their respective fathers, the general partners.

STATUTES AND REGULATIONS INVOLVED

The statutes and Regulations involved will be found in the Appendix, *infra*.

STATEMENT

The decision below was reviewed by the entire Tax Court (R. 692), and was rendered by a closely divided court. Six judges joined in a dissenting opinion. (R. 693-696.) Judge Turner additionally dissented without opinion. (R. 692.)

The deficiencies determined by the Commissioner resulted from several adjustments to taxpayers' net income, as disclosed by their tax returns for the years in question. Most of these issues were settled by stipulation (R. 657), which left for consideration only two

issues. The first litigated issue was whether Western Construction Company was an association taxable as a corporation. (R. 657-658.) The second litigated issue was presented in the alternative, and arose only if the first issue was decided against the Commissioner, namely, in the event Western Construction Company was held not to be taxable as a corporation, but regarded taxwise as a partnership, then who were to be recognized as the firm members; did they include only the three fathers, the general partners, or also their several children, the so-called limited partners.

The Tax Court made findings based partly on stipulation (R. 197-201) and partly on evidence consisting of testimony and exhibits as follows (R. 659):

Taxpayer, Western Construction Company, was created as a limited partnership under the laws of the State of Washington, and filed partnership returns for the taxable years 1942 to 1945, inclusive. Taxpayers J. A. Johnson, George Johnson, and Albin Johnson are the three general partners of taxpayer Western Construction Company. Taxpayer Huldah Johnson is the wife of George Johnson and taxpayer Ellen Johnson is the wife of J. A. Johnson, and these taxpayers are involved solely because of their community property status with their husbands. (R. 660.) [1]

The three Johnsons are brothers. In 1909 George and J. A. formed a partnership, known as Johnson Brothers, to engage in the general construction busi-

[1] Lloyd Johnson, a son of George Johnson, and the former's wife, Roberta, were also parties to the proceeding in the Tax Court, but their deficiencies were adjusted by stipulation at the hearing (R. 660, 682), and hence, they are not parties to the instant appeal.

ness. In 1934 Albin was admitted to the partnership as an equal partner under an oral agreement and operated under the name of the Western Construction Company, with offices at Seattle, Washington. At first the partnership built small homes, but gradually expanded into larger lines of construction as its capital increased; however, the business was always run as a family affair. The sons of the partners worked for the company from their early teens during school vacations, and the daughters worked as clerks or stenographers prior to the taxable years involved herein. (R. 660-661.)

In 1935 the partnership suffered a large loss in connection with a contract for the construction of bridge piers at the Grand Coulee Dam in the State of Washington. From 1936 to 1940 the partnership did not actively engage in the construction business. However, it was not dissolved, but was kept alive for the purpose of paying off creditors and prosecuting its claims. (R. 661.)

To enable the partners to continue in business, obtain necessary loans, and pay off their indebtedness, the bank and the bonding company advised that they do business as a corporation. On October 9, 1935, a corporation was organized under the name of "Western Construction Company, Inc.", and continued business during the years 1936 to 1940. The bank insisted that the incorporators and officers of the corporation be two sons of the former partners and the bookkeeper. While the stock was issued to the sons, the beneficial owners were the three Johnson brothers. By 1941 the brothers prospered sufficiently to pay off the entire indebtedness

of Western Construction Company and of the three brother partners, incurred as a result of the Coulee Dam project. Thereupon it was decided to dissolve the corporation and revert to the partnership form of business. Prior to the dissolution, the incorporators turned over their stock to the three brothers, who then became the officers of the corporation. The dissolution was completed in 1942. (R. 661-662.)

During the time the corporation was in existence, J. A., George and Albin also did some business as general partners of the Western Construction Company. In 1940 they secured a very large contract, known as the West Park Housing project, at Bremerton, Washington, which was performed as a joint venture, composed of the three brothers and another individual because the partners did not have the financial backing themselves to secure the necessary bond. Subsequently it was discovered that the other joint venturer was of no real financial help to the partnership; nevertheless, the agreement required a split of the profits. In 1941 the partnership also received a contract for the Rainier Vista project. The contract was a financial success and was completed by Western Construction Company, the limited partnership and taxpayer herein. (R. 662-663.)

Early in 1941 the three brothers, who had no formal engineering training, discussed among themselves and with their three sons, the formation of a partnership consisting of fathers and sons. Two of the boys were graduate engineers, with considerable experience, and Albin's son, Winston, had attended engineering school for three years and had worked for his father and the

other Johnson brothers in the construction business. On January 6, 1941, articles of copartnership naming the six individuals as partners were prepared and executed by them. The agreement contemplated preserving in the three fathers the value of the assets then owned by the old partnership and allowing the sons to participate, without any capital investments, only in the increase in the value of the new partnership from the date of the agreement. The agreement also provided that each of the six partners should actively work for the partnership; that salaries should be determined and paid the six of them based upon services; and that thereafter the partnership profits would be divided equally among the six partners. This partnership, however, never actively operated and no books or accounts were ever set up for it. (R. 663-664.)

The three brothers were anxious to bring their children into the business, especially their sons, who had engineering training which the brothers lacked. Again, one of the big problems that confronted the brothers was that, largely because of their limited finances, they were unable to obtain bonds required in securing the large and more lucrative Government contracts. They endeavored to persuade other companies to join them on bids, but the West Park project at Bremerton indicated that this was not a satisfactory solution. They also tried unsuccessfully to get outsiders to invest in the partnership. Thus, faced with the desire to include their children in the business and with the need of additional financial backing, the brothers decided to form a limited partnership in which the brothers would be the general partners and their adult children the

limited partners. This decision was made without discussion with tax counsel, accountants, or attorneys as to whether it would be cheaper to do business as a partnership rather than as a corporation. (R. 664.)

The proposed partnership contemplated that each of the Johnson brothers would have a capital investment of $20,000 and the children of each of the brothers a like capital investment of $20,000, divided equally among the children becoming limited partners. On February 24, 1942, they formed a limited partnership, Western Construction Company, taxpayer herein, consisting of the three Johnson brothers as general partners, and seven limited partners, being their three adult sons and four adult daughters. (R. 664-665.)

The agreement, so far as relevant, read as follows (R. 665-669):

> Certificate of Formation of a Limited Partnership
>
> State of Washington
> County of King, ss:
>
> We [names of the general and limited partners] * * * having formed a limited co-partnership pursuant to the laws of the State of Washington, do hereby certify and state:
>
> I
>
> That the name of the co-partnership is Western Construction Company.
>
> II
>
> That the character of the business is general contracting.

III

That the location of the principal place of business and office is in the Textile Tower, City of Seattle, County of King, and State of Washington.

IV

* * * * *

[The names and residences of each member, general and limited partners, designated as such, are listed. All resided in Washington, except one daughter, a resident of Ohio.]

V

That the term for which the partnership shall exist is for ten (10) years from January 2nd, 1942.

VI

That the amount of cash contributed by each Limited Partner is as follows: $10,000 each, by each Limited Partner, except Roy W. Johnson, Eleanor J. Rector and Evelyn J. Borgens who contributed $6,666.66 each.

VII

The time when the contribution of each Limited Partner is to be returned, is agreed to be the end of said partnership as above stated, to wit, ten (10) years from January 2nd, 1942.

VIII

The share of proceeds by way of income which each Limited Partner shall receive by reason of his contribution, is as follows: The General Partners, and each of them, are to receive a salary per year, to be fixed by them in a reasonable amount to

cover their superintendence and management of the work and business, in proportion to the amount of work done by them, each year, taking into account the amount of the net profit of the partnership each year, never to exceed the sum of $15,000.00 a year salary to any one of the General Partners.

After the payment of said salaries to said General Partners and deduction of all other expenses of the partnership, the net income or proceeds shall be divided among the partners both general and limited on the basis of their financial interest in said partnership, as shown by the books of the partnership.

IX

The General Partners are hereby given the right to admit additional Limited Partners in the future upon the agreement of the General Partners hereto, but in no event other than upon a cash contribution to the partnership, and upon the same terms as herein expressed.

X

The entire management of the partnership shall be vested in the three General Partners and the right is hereby given to the remaining General Partners to continue the business upon the death or retirement of a General Partner, and the right is also given to the General Partners to continue the business upon the death or retirement of any of the Limited Partners hereto.

XI

It is understood and agreed between all of the partners that a Limited Partner shall not receive

out of partnership property any part of his contribution until all liabilities to the General Partners and Limited Partners on account of their contribution, have been paid or their [*sic*] remains property of the partnership sufficient to pay them.

XII

The interests of all the Limited Partners herein may be transferred upon the approval of the General Partners to accept a new assignee as a Limited Partner in this co-partnership, and not otherwise.

XIII

No General Partner shall demand or receive any property other than cash in return for his contribution and each General Partner's interest in this partnership shall be fixed as of the date of January 2nd, 1942, by the books of the co-partnership.

* * * * *

Pursuant to this agreement the partners and their capital accounts were as follows (R. 670):

General Partners:	Capital
Albin Johnson	$15,000.00
George Johnson	15,000.00
J. A. Johnson	15,000.00
Limited Partners:	
Albin's Children:	
Winston Johnson	10,000.00
Elsie Keil	10,000.00

George's Children:

Bernice Wallin	10,000.00
Lloyd Johnson	10,000.00

J. A.'s Children:

Roy Johnson	6,666.66
Eleanor Rector	6,666.66
Evelyn Jorgens	6,666.66

The limited partners made their cash contributions to the partnership with money they borrowed from their respective fathers. The fathers drew checks on moneys they had to their credit on the books of Western Construction Company and delivered these checks to their children. In return each child gave his or her promissory note payable to the father. Each limited partner then gave the limited partnership a check in the amount of the loan in payment of his or her limited partnership interest. The partnership itself did not thereby increase its assets; however, each of the general partners had in his possession $20,000 worth of notes signed by his children. These notes were never pledged as collateral for any loan, but they were listed as personal assets of the general partners in applications for construction bonds. On July 30, 1942, an additional $50,000 was borrowed from a bank. (R. 670-671.)

Each of the children knew and understood he was signing a note which was unconditionally payable and which represented a bona fide obligation on his part. They did not take on these obligations lightly as there was considerable discussion about the notes before signing them. While none of the husbands of the John-

son daughters signed any of these notes given to the general partners, generally speaking, the notes were signed by the wives with the knowledge and consent of their husbands. Rachel Gustafson, the daughter of George Johnson, was invited to participate in the first limited partnership. However, she declined to do so as both she and her husband did not desire to sign a note for $5,000. They knew that the construction business is subject to heavy losses, as well as handsome profits. Rachel had seen at first hand the Coulee Dam fiasco, with its resulting damaging effects to the partnership. Her husband had changed his course of study at the university from premedical to engineering at the urging of his father-in-law. When he graduated there was no work available in engineering, so he entered the meat business and at present is the owner of a butcher shop. (R. 671-672.)

Those notes did not provide that they were payable solely from business profits, but, on the contrary, there was a general understanding among the limited partners that they were entering a normal business transaction upon the signing of the notes. The financial situation of the limited partners of the 1942 partnership was good, and each had sufficient assets to cover his or her liability on the notes. This was especially true of the three sons of the respective general partners. Two of the sons had already achieved considerable prominence and success in the business world. Though the sons-in-law did not sign the notes, they treated these obligations as resting on their community property. An example of all the notes which were given by the limited partners to their fathers is the

note of Eleanor J. Rector given to her father, J. A. Johnson. It reads as follows (R. 672-673):

> $6,666.66 Seattle, Wash. April 21st, 1942
>
> One year after date, without grace, for value received I promise to pay to the order of J. A. Johnson Six Thousand Six Hundred Sixty-six Dollars and Sixty-seven Cents, in Lawful Money of the United States of America, of the present standard value, with interest thereon in like Lawful Money, at the rate of 4 per cent per annum from date until paid. Interest to be paid at maturity and if not so paid, the whole sum of both principal and interest to become immediately due and collectible at the option of the holder of this note. And in case suit or action is instituted to collect this note or any portion thereof I promise and agree to pay in addition to the costs and disbursements provided by statute such sum as the court may adjudge reasonable as attorney's fees in said suit.
>
> Due April 21st, 1943.
>
> [S.] Eleanor J. Rector.

When other children of the general partners found that their brothers and sisters had done so well in the 1942 partnership they too wanted to acquire an interest for themselves. (R. 674-675.) On June 30, 1943, a new limited partnership was formed on substantially the same basis as the former one, excepting that three additional children were brought into the partnership as limited partners, namely, two daughters of George Johnson, and a daughter of Albin Johnson. The capital of the general partners remained at $20,000 each. (R. 673.) The capital of the limited partners was

changed by consent of all parties as follows (R. 673-674):

	Capital
Albin's children:	
Winston Johnson	$6,666.66
Elsie Keil	6,666.66
Vedola Johnson	6,666.66
George's children:	
Bernice Wallin	5,000.00
Lloyd Johnson	5,000.00
Betty Ellingson	5,000.00
Rachel Gustafson	5,000.00
J. A.'s children:	
Roy Johnson	6,666.66
Eleanor Rector	6,666.66
Evelyn Jorgens	6,666.66

None of the new partners made a direct contribution of capital to the partnership. Rachel Gustafson and Betty Lorraine Ellingson (daughters of George) each obtained a division of the interests which had been held in the names of their sister and brother, Bernice Wallin and Lloyd Johnson. This was accomplished by the unpaid notes of the latter partner being returned to them by their father and new notes in the amount of $5,000 being given by each of the four children to their father. Vedola Johnson (daughter of Albin) was taken in as a limited partner in the same way as Rachel Gustafson and Betty Lorraine Ellingson, daughters of George, were taken in. Her brother Winston and sister Elsie Keil had their notes for $10,000 each returned

to them and each executed a note for $6,666.66, payable to their father. (R. 674.)

The interests of the three Johnson families were always kept equal in the various partnerships. (R. 675.)

The moneys which these adult children borrowed from their fathers and used to invest in the limited partnership were bona fide loans. The general partners had minor children, but they were not taken into the partnership because they wanted notes from adults, fully responsible for payment. The notes were negotiable, bore interest, and were all for short terms not exceeding two years, except the first two notes of Lloyd Johnson and his sister Bernice Wallin to their father George Johnson for $10,000 each. These notes were installment notes, payable in yearly installments of not less than $3,500 in any one payment. Some of the notes given by the limited partners were paid in 1945. Lloyd paid his note in 1946; Winston and Elsie paid their notes in 1947. Rachel has not paid her note, as no demand has been made for payment from her by her father. (R. 675.)

The limited partnership was not the result of an impulse set off by the desire to minimize taxes, but rather the result of many years of thought by the general partners, who were anxious to have their sons, daughters, and sons-in-law come into the business so that it would continue after the general partners retired or died. (R. 676.)

Just prior to the formation of the partnership it appeared that Lloyd and Roy were drifting away from the business to other attractive jobs. Their talents

and training were in demand by others. For some years prior to 1942 Lloyd had worked for various individuals and companies other than Western Construction Company. In 1941, Lloyd, contrary to his father's wishes, formed a construction partnership with Max J. Kuney of Spokane, Washington, in which each had a one-half interest. When the Kuney-Johnson partnership was formed there was no plan for its being a permanent association, but that partnership opened offices in Seattle, Washington, and has been successfully active in the construction business from that time down to the present. Lloyd did not work as an employee of the limited partnership, but he did perform important services for the firm. He was a graduate engineer, with a great deal of experience. In 1942 and 1943 he was consulted by the general partners on matters relating to pricing and estimating pricing jobs, figuring bids, and helping them get scarce materials such as nails which were almost impossible to get. Pricing was a very important work during the war years because prices changed so fast. The partners telephoned Lloyd a great deal on business matters of the company. He also did a great deal of night work helping the general partners on matters relating to engineering, bids, and estimates. He did not receive any compensation for this work, but he devoted a considerable amount of his time because of his interest as a limited partner. It was of great value to the partnership. (R. 676-677.)

Roy Johnson was engaged for many years prior to 1942 in businesses other than that of the Western Construction Company. He rendered no regular services to the limited partnership until January, 1943, when

he devoted full time to its affairs. In 1942 he assisted the partnership by advising it on estimates and by performing engineering work for it. From January, 1943, until June, 1944, Roy worked full time for the partnership and was paid a salary of $2.05 an hour. During this period he worked as an engineer designing layout foundations, excavating footings, roads, buildings, arches and superintending both large and small jobs. He estimated various projects and did some difficult engineering work which the general partners could not do. In June, 1944, Roy went to Alaska to assist with a hydroelectric project. He remained there until the fall of 1947, working on this project, which had no connections with the Western Construction Company. (R. 677-678.)

Winston Johnson, son of Albin Johnson, worked for the partnership at all times after March, 1942, when he was released from the army. Winston, who had three years of college training as a civil engineer, did various types of work for the firm. He worked in the office, estimated jobs, obtained materials, arranged subcontracts, represented the partnership before the Navy on problems relating to contracts, and supervised jobs. His pay for this work was $80 or $90 a week which was somewhat below the standard for estimators some of whom earned $30,000 a year working on a salary plus bonus basis. (R. 678.)

The daughters did not render any services to the limited partnership of any substantial consequence. (R. 678.)

With the exception of Harold Ellingson, Betty's husband, none of the sons-in-law worked for the limited

partnership, and Ellingson worked as a carpenter, for only three months of the taxable years here involved. The general partners hoped that some day most of the sons-in-law would be associated with the partnership. (R. 678.)

The limited partnerships were very successful and made large net profits, which were credited each year to the partners on the basis of their capital accounts. In determining net profits there was first subtracted $15,000 for each general partner as salary. The 1942 profits were several times more than the expectations of the general partners, and the crediting of profits to each partner was more than three and one-half times his capital account; however, the construction business represents a hazardous financial risk and it is possible to lose heavily as well as to realize large profits. (R. 675.)

The partnership reported its profits for tax purposes upon a completed contract basis. This was true of the Quartermaster and Rainier Vista contracts, which were under way by the time the first partnership was created. Gross profits were realized upon the Quartermaster and Rainier Vista contracts in the respective amounts of $234,886.20 and $201,754.39, which were reflected in the 1942 return of the limited partnership. Division of such profits was made with the limited partners on the basis of their stated partnership interests. (R. 676.)

The partnership profits were regarded by all of the limited partners and their spouses as community property and in the filing of their returns for the years 1942 to 1945 inclusive, such profits were divided in the

returns of the spouses on a community property basis the same as other income. Substantially all of the returns of the limited partners and their spouses for the years 1942 to 1945, inclusive, were prepared at the office of the Western Construction Company by the accountant who handled the affairs of the partnership. (R. 678-679.)

Partnership checks representing distribution of profits were sometimes made out to the limited partners, and sometimes to the spouses of the limited partners, depending upon which one requested the money. It was regarded as a family business and no distinction was made as between limited partners or his or her spouse when it came to distributing the profits. There were no profits credited to the account of the limited partners and no withdrawals by them until after the close of the taxable year ended December 31, 1942. The limited partners were entitled to withdraw their share of the profits as they pleased and the shares of the profits credited to the individual partners' accounts were in no way considered to be anything but their own property. No limited partners ever withdrew any profits and turned them over in any way to the father, the general partner. No limited partner was in any way dependent upon his or her father, the general partner, for support either at the time of the formation of the partnership or later. (R. 679.)

The freedom of withdrawals by the limited partners without consulting the general partners is illustrated by the various uses they made of their profits. Roy Johnson in 1945 withdrew $40,000 to invest in his own construction project in Alaska. At one time he over-

drew $6,600 for working capital in his Alaskan project, which he returned when the bookkeeper notified him of that fact. Winston Johnson withdrew $2,333.50 to pay for an engagement ring, the cost of his honeymoon, his mother's funeral expenses, and personal items. He also withdrew $2,700 to purchase a lot for his home and later $36,509.69 to invest in the stock of another company. Lloyd Johnson withdrew $9,000 of his profits to invest in a restaurant. The greater portion of his withdrawals were for uses other than the payment of income taxes. Elsie Keil used some of her profits to pay personal bills and also withdrew $49,976.52 to buy stock in another company. Vedola Johnson withdrew $6,586 of her profits to purchase stock in another company. Evelyn Jorgens invested $8,500 of her profits in a chicken ranch. Rachel Gustafson made withdrawals only to pay income taxes, as she had no other need for the money. Bernice Wallin withdrew $5,000 of her profits to invest in a real estate business and made a number of other personal withdrawals. Betty Ellingson used some of her profits for personal expenses. (R. 679-680.)

The three general partners managed the limited partnership in the same manner that they had the business which preceded the limited partnership. As general partners, the management and direction of the business was in their hands and all their personal assets, including the notes of the limited partners, were subject to possible loss in the event the limited partnership failed. The sons who were limited partners worked under the direction of the general partners. Only the

general partners could sign checks or notes for Western Construction Company. (R. 680-681.)

There was no delegation of authority by the limited partners to the general partners. The limited partners held no meetings regarding such delegation of authority, elected no officers and representatives, and received no certificates or other evidence of their contribution as limited partners, other than the partnership articles. (R. 681.)

The limited partnerships were not operated with any of the usual formalities of a corporation or association. There were no officers, no regular or formal meetings, no bylaws, board of directors, seal, or minute books. The Western Construction Company held itself out to the public as a true limited partnership. The parties to the limited partnership agreements here involved formed a bona fide partnership and truly intended to join together for the purpose of carrying on the business as a partnership. It was not an association taxable as a corporation. Proper statutory notice of the formation of both limited partnerships was given. The limited partnership agreements provided that the general partners could admit additional limited partners and continue the business upon the death or retirement of a general or limited partner. Those rights could be exercised only by agreement among the general partners. (R. 681-682.)

Based upon these findings the majority of the Tax Court in an opinion by Judge Black held against the Commissioner on both issues. On the first issue (R. 683-687), on the authority of its earlier decision in

Glensder Textile Co. v. *Commissioner,* 46 B.T.A. 176, the majority of the tribunal below ruled substantially without discussion here that Western Construction Company was not an association taxable as a corporation (R. 686-687). On the alternative issue (R. 687-692), the majority held that, looking at the evidence as a whole, Western Construction Company was intended and created as a valid business partnership including all the limited partners and must therefore be recognized as such for tax purposes (R. 692).

Judge Turner dissented without opinion. (R. 692.) Judge Opper dissented in an opinion in which five other judges joined. (R. 693-696.) Accordingly, the Tax Court in its ruling below was closely divided. Assuming all sixteen judges passed on the instant case, the majority opinion represents the views of nine judges as opposed to seven in dissent.

From the adverse decisions of the Tax Court, entered upon this close division of opinion below, the Commissioner seeks the instant review by this Court.

STATEMENT OF POINTS TO BE URGED

I

With respect to taxpayer Western Construction Company, the Tax Court erred (R. 39-40):

1. In entering its decision that there are no deficiencies in income tax, declared value excess profits tax and excess profits tax for the calendar years 1942, 1943, 1944 and 1945.

2. In failing and refusing to sustain the deficiencies in tax determined by the Commissioner insofar as such

deficiencies resulted from his determination that taxpayer was, during the taxable years involved, an association taxable as a corporation.

3. In holding and deciding that the taxpayer does not resemble an association in corporate form and is, therefore, not taxable as a corporation.

4. In failing and refusing to hold and decide, as determined by the Commissioner, that the taxpayer, under the so-called limited partnership agreements of February 24, 1942, and June 30, 1943, constituted an association taxable as a corporation as prescribed by Section 3797 (a) (3) of the Internal Revenue Code and the Commissioner's regulations.

5. In that its ultimate finding that the taxpayer was not an association taxable as a corporation and its opinion and its decision are not supported by but are contrary to the evidence.

6. In that its opinion and its decision are contrary to law and the Commissioner's Regulations.

II

With respect to the remaining five individual taxpayers the Tax Court in each case erred (R. 73-74, 104-105, 135-136, 166-167, 196-197):

7. In holding and deciding that the Western Construction Company is a bona fide partnership composed of the three Johnson brothers and their several children as set out in the certificate of formation of the partnership and is recognized as such for tax purposes.

8. In failing and refusing to hold and decide that the Western Construction Company, during the taxable

years involved, was a partnership consisting only of its three general partners, and that for federal income tax purposes the income of such partnership was taxable to the general partners and their respective spouses and that the children of the general partners should not be recognized, for federal income tax purposes, as bona fide partners in the business conducted by the Western Construction Company.

9. In that its opinion and its decision that, for federal income tax purposes, the Western Construction Company is a bona fide partnership composed of the three Johnson brothers and their several children as set out in the certificate of formation of the partnership are not supported by but are contrary to the evidence.

10. In that its opinion and its decision are not supported by but are contrary to the evidence.

11. In that its opinion and its decision are contrary to law and the Commissioner's Regulations.

III

In the case of taxpayer Albin Johnson the Tax Court further erred (R. 72-73):

12. In entering its decision that there are deficiencies in income tax for the calendar years 1943, 1944 and 1945 in the respective amounts of only $9,311.96, $834.40 and $2,669.06.

13. In failing and refusing to sustain the deficiencies in tax determined by the Commissioner on the basis that the taxpayer was taxable upon one-third of the net income of the business conducted under the name of Western Construction Company, less the community

portion of such income allocable to taxpayer's wife, as modified by stipulation and agreement of the parties in respect of items not now in controversy.

In the case of taxpayer Ellen M. Johnson the Tax Court further erred (R. 104):

14. In entering its decision that there are deficiencies in income tax for the calendar years 1943 and 1944, in the respective amounts of only $3,348.71 and $357.89, and that there is an overpayment in income tax for the calendar year 1945, in the amount of $232.81.

15. In failing and refusing to sustain the deficiencies in tax determined by the Commissioner on the basis that the taxpayer's husband, J. A. Johnson, was taxable upon one-third of the net income of the business conducted under the name of Western Construction Company, less the community portion of such income allocable to the taxpayer, Ellen M. Johnson, the wife of J. A. Johnson, as modified by stipulation and agreement of the parties in respect of items not now in controversy.

In the case of taxpayer Huldah Johnson the Tax Court further erred (R. 134-135):

16. In entering its decision that there are deficiencies in income tax for the calendar years 1943 and 1944 in the respective amounts of only $3,650.23 and $339.85, and that there is an overpayment in income tax for the calendar year 1945 in the amount of $228.79.

17. In failing and refusing to sustain the deficiencies in tax determined by the Commissioner on the basis that the taxpayer's husband, George J. Johnson, was taxable upon one-third of the net income of the business

conducted under the name of Western Construction Company, less the community portion of such income allocable to the taxpayer, Huldah Johnson, the wife of George J. Johnson, as modified by stipulation and agreement of the parties in respect of items not now in controversy.

In the case of taxpayer George J. Johnson the Tax Court further erred (R. 165-166):

18. In entering its decision that there are deficiencies in income tax for the calendar years 1943 and 1944 in the respective amounts of only $2,815.43 and $322.38, and that there is an overpayment in income tax for the calendar year 1945 in the amount of $216.54.

19. In failing and refusing to sustain the deficiencies in tax determined by the Commissioner on the basis that the taxpayer was taxable upon one-third of the net income of the business conducted under the name of Western Construction Company, less the community portion of such income allocable to taxpayer's wife, as modified by stipulation and agreement of the parties in respect of items not now in controversy.

In the case of taxpayer J. A. Johnson the Tax Court further erred (R. 195-196):

20. In entering its decision that there are deficiencies in income tax for the calendar years 1943 and 1944 in the respective amounts of only $2,886.91 and $357.89, and that there is an overpayment in income tax for the calendar year 1945 in the amount of $232.81.

21. In failing and refusing to sustain the deficiencies in tax determined by the Commissioner on the basis

that the taxpayer was taxable upon one-third of the net income of the business conducted under the name of Western Construction Company, less the community portion of such income allocable to taxpayer's wife, as modified by stipulation and agreement of the parties in respect of items not now in controversy.

SUMMARY OF ARGUMENT

The two issues which these proceedings present are in the alternative. The first question is whether taxpayer, Western Construction Company, is an association taxable as a corporation. If this question is answered in the affirmative and the Court holds in accord with the Government's contention that the Western Construction Company is taxable as a corporation, the second question is not reached for consideration.

1. The mandate of the statute, as construed by the highest authority, requires taxation of Western Construction Company as an association taxable as a corporation. The scope of review by this Court on that issue is not limited, since the question presented is one of law, namely, of application of the taxing statute, Treasury Regulations, and judicial authorities to undisputed and principally documentary facts. Moreover, the majority of the Tax Court ruled on the question, not as a fact question tied to the particularities of the instant record, but on a point of law regarded by it as settled by its prior decision in a case which involved a different record, a different limited partnership and a different state statute. The ruling of the Tax Court majority was instantly not based upon any factual judgment but upon an opinion—mistaken as we contend—

that denial of the Commissioner's contention was required as a matter of law.

A business enterprise which has obtained most of the organizational advantages of incorporation should be taxed as a corporation. The legislative purpose is clearly to place in the same tax category, business organizations essentially of the same character, regardless of formal technicality.

The legislative inclusion of associations with corporations implies resemblance, but it is resemblance and not identity. The instant business enterprise indisputably meets two basic corporate criteria, namely, (1) association in a common enterprise, and (2) for the purpose of carrying on a business. Moreover, additionally the business enterprise, Western Construction Company, obtained through agreement of the parties participant powers granted in the limited partnership certificate filed in a public office, the essential organizational advantages of incorporation. Thus, (1) it possessed the capacity, as a unit, to acquire, hold, and dispose of property, and to deal with its property separate from its members' individual property. (2) Management of its affairs was centralized in the three general partners acting in a representative capacity. (3) By means of a special agreement and powers conferred in the limited partnership certificate, continuity of the business was assured notwithstanding the death or retirement of a general or limited partner. Indeed, the record establishs the conscious purpose of both the general and the limited partners for the business to continue after the general partners retired or died and the limited partnership was clearly given the power and

deliberately shaped to carry out this purpose. Where parties operate under an instrument, their relationship is governed by the powers conferred by the instrument rather than by what the parties may have done in exercise of the conferred powers. (4) Reasonable transferability of beneficial interests was also provided substantially identical to that commonly obtained in formally incorporated close family businesses. (5) The liability of the special partners was limited to the amount of their investment as in the case of stockholders. Under the authorities complete limitation of all beneficiaries' liability is not requisite to corporate classfication for taxpayers.

In summary, if the general partners are thought of as common stockholders and the special partners as holders of participating preferred stock, the entire arrangement is identical with a corporate structure, except for the unlimited liability of the general partners.

Finally, special provisions of the controlling Washington law add to taxpayer's corporate resemblance.

2. Alternatively, Western Construction Company fails to bear any resemblance to an actual partnership of which the limited partners were component members. If the limited partners (resembling preferred stockholders) are not associated with the general partners (resembling common stockholders) in an enterprise taxable as a corporation, then the so-called limited partners are not actual participants in the business at all. Their role then is merely that of partial assignees of their respective fathers' income and the so-called limited partnership is taxwise—so far as the children are concerned—merely an arrangement for anticipa-

tory assignment of income. Under such circumstances the finding of the Tax Court majority that all the parties formed a bona fide partnership and intended to join together for the purpose of carrying on a partnership business is clearly erroneous. There was no change in the operation or management of the business after the formation of the limited partnership, the daughters performed no services, and such services as the sons performed were under the direction of the general partners. Furthermore, the notes given by the children were not owned or used by the partnership as such, but constituted separate assets of the three individual general partners to whom they were payable. The conclusion of the Tax Court that possession of these notes was a factor of considerable importance to the financial status of the general partners and through them to the limited partnership, is clearly erroneous, in view, among others, of the finding that the notes were never pledged as collateral, but were merely listed as personal assets of the general partners in application for construction bonds. Further, two large government contracts were partially completed when the first limited partnership agreement was executed, yet all profits were divided and the amounts credited to the children were out of reasonable proportion to their stated capital contributions. The total cost of each of the two government contracts was eventually between a million and a quarter and a million and a half dollars and the aggregate profits inuring from them in the first year of the limited partnership exceeded $436,000. In view of the foregoing, it seems clear error for the Tax Court to have found that the $60,000 credit, which the children contributed in

this unusual and circuitous manner, was of any substantial importance to the financial status of the business or of the general partners, and to have concluded that the partnership possessed reality as to the limited partners.

ARGUMENT

I

The Issues

The significant tax problem, which the instant case presents, finds apt expression in the dissenting opinion as follows (R. 693):

> For the first time since *Tower, Lusthaus* and *Culbertson,* this case raises the question whether a family enterprise cast in the form of a limited partnership, just because it truly represents an actual form of doing business, is not in reality more nearly like a corporation than any other business organism.

The two issues which these proceedings present are in the alternative. (R. 659, 682.) The first question is whether taxpayer, Western Construction Company, is an association taxable as a corporation. If this Court should answer this first question in the affirmative and hold in accord with the Commissioner's contention that Western Construction Company is taxable as a corporation, the second question will not be reached and need not here be considered.

On the other hand, if this Court should decide on the first issue that Western Construction Company is not taxable as a corporation but is instead a partnership, then alternatively the second question is presented,

namely, the correct composition of the partnership for tax purposes, that is, whether the partnership, Western Construction Company, consisted, as the Commissioner contends, only of the three general partners, or, on the other hand, whether the Tax Court properly recognized the children of the three general partners additionally as members of the firm.[2]

The two alternative issues, however, possess a common character, which the dissenting opinion further points out, as follows (R. 693):

> The two issues before us cannot be neatly severed, so that we can separately deal with the reality of the partnership and its resemblance to a corporation. * * * The very aspects upon which peti-

[2] The Commissioner pointed out below that he had made inconsistent determinations in holding that Western Construction Company was an association taxable as a corporation, and at the same time determining that the same business during the same period was a general partnership composed of three members, and conceded that both determinations cannot stand. (R. 682.) Thus, in protection of the revenue only and not with the intention of ultimately taxing the same income to more than one of the taxpayers, the Commissioner has included the same income in determining the tax liability asserted against Western Construction Company as an association taxable as a corporation and also alternatively against the individual partners. Accordingly, in the event of reversal by this Court of the decision below on either one of the alternative two issues, necessary adjustments to avoid duplication in inclusion of income, as heretofore protectively determined by the Commissioner with respect to the several taxpayers, will be required to be made in the Tax Court under its Rule 50.

The aggregate deficiencies which the Commissioner determined against each taxpayer were as follows:

Western Construction Company	$728,832.16
Albin Johnson	123,675.85
Ellen Johnson	38,467.40
Huldah Johnson	39,812.41
George J. Johnson	38,828.50
J. A. Johnson	37,903.24

The items, which compose these aggregates, are set forth as to year and kind of taxes under Jurisdiction, *supra*. (See also R. 656-657.)

tioners rely to strengthen their claim of a valid partnership and yet to explain the relation to the business of the "limited partners" are in fact and in essence the *Morrissey* type of corporate characteristics.

II

The Mandate of the Controlling Statute, as Construed by the Highest Authority, Requires Taxation of the Business organization, Western Construction Company, as an Association Taxable as a Corporation

A. *The error asserted is an error in law*

The scope of review by this Court of the ruling below on the instant issue is not limited, since the question presented is one of law. The conclusion by the Tax Court that Western Construction Company was not an association taxable as a corporation on the instant record presents a question of law and not of fact for review by this Court.

1. The facts with respect to this issue are not in dispute and no question of credibility was decided by the tribunal below. Essentially the problem is one of the legal effect of the limited partnership agreement whose terms are documentary and set forth in the filed certificate of its formation, incorporated in the Tax Court's findings (R. 665-669) and quoted in the Statement, *supra*. Thus, the problem is one of application of the taxing statute, Treasury Regulations and judicial authorities to undisputed facts. Indeed, this Court has repeatedly viewed this issue, namely, whether a given taxpayer constitutes an association taxable as a corporation within the meaning of the Internal Revenue Code, as presenting a question of law and reversed lower court holdings, passing upon it when regarded

as incorrect, for error in law. Thus, in *United States* v. *Homecrest Tract,* 160 F. 2d 150, this Court, reversing a contrary holding of the District Court, ruled that a trust there constituted an association taxable as a corporation and said (p. 153):

> In the instant case the bulk of the record stands on documentary and stipulated evidence. The oral evidence adduced at the trial is not conflicting, nor does it present a question of credibility of the story teller. So the facts are not in dispute. The problem is one of construction of the trust instrument and the application of the taxing statute. The findings of the district court bring this transaction within the express terms of the taxing statute as it is interpreted by the noted regulation.

To the same effect are the earlier decisions of this Court in *Commissioner* v. *Vandegrift R. & Inv. Co.,* 82 F. 2d 387, 390; *Commissioner* v. *Fortney Oil Co.,* 125 F. 2d 995; *Helm & Smith Syndicate* v. *Commissioner,* 136 F. 2d 440; and *Commissioner* v. *Security-First Nat. Bank,* 148 F. 2d 937. See also *Wabash Oil & Gas Ass'n* v. *Commissioner,* 160 F. 2d 658 (C.A. 1st), certiorari denied, 331 U.S. 843, where the Court of Appeals for the First Circuit recognized that this Court treats the instant issue as one of law.

2. Moreover, the Tax Court itself ruled on the question as one of law and not of fact, for, as already pointed out in the Statement, *supra,* the holding adverse to the Commissioner's contention was here made on the authority of a prior decision of the tribunal below in *Glensder Textile Co.* v. *Commissioner,* 46 B.T.A. 176.

(R. 686-687.) Thus, the Tax Court resolved the issue here, not as a fact question tied to the particularities of the instant record, but on a point of law, regarded by it as settled by its prior cited decision in a case which involved a different record, a different limited partnership, and a different state statute. The ruling of the Tax Court instantly thus was not based upon any factual judgment or factual conclusion but upon a conviction—mistaken as we contend—that denial of the Commissioner's contention was required as a matter of law. Indeed, even during the period when *Dobson* v. *Commissioner,* 320 U.S. 489, rehearing denied, 321 U.S. 231, controlled (prior to its legislative overruling by amendment of Section 1141 (a) of the Internal Revenue Code by Section 36 of the Act of June 25, 1948, c. 646, 62 Stat. 869), such a ruling by the Tax Court was held to raise a question of law, subject to full appellate review. *Commissioner* v. *Heininger,* 320 U.S. 467, 475.

B. *The governing legal principles*

The basic legislative purpose in classifying "associations" as corporations is to place in the same tax category organizations of essentially the same character, regardless of formal technicality. A business enterprise, which obtains most of the organizational advantages of incorporation, should be taxed as a corporation. Hence, the fundamental question in a given case is whether taxpayer by agreement or by certificate filed pursuant to state statute or otherwise has achieved an organization possessing the advantages, which typically follow corporate charter.

The controlling Internal Revenue Code contains the following definitions which, indeed, had previously been enacted repeatedly in earlier Revenue Acts (Appendix, *infra*):

> SEC. 3797. DEFINITIONS.
>
> (a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—
>
> * * * * *
>
> (2) *Partnership and Partner.*—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, *and which is not, within the meaning of this title,* a trust or estate or *a corporation;* and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.
>
> (3) *Corporation.—The term "corporation" includes associations,* joint-stock companies, and insurance companies. (Italics supplied.)[3]

Long standing Treasury Regulations quoted in the footnote,[4] correctly mark out the statutory meaning.

[3] Congress first enacted the quoted definition of "Partnership and Partner" in the Revenue Act of 1932, c. 209, 47 Stat. 169, Sec. 1111 (a)(3), and the quoted definition of "Corporation" in the Revenue Act of 1918, c. 18, 40 Stat. 1057, Sec. 1.

[4] Treasury Regulations 111 (Appendix, *infra*):

> SEC. 29.3797-1. *Classification of Taxables.*—For the purpose of taxation the Internal Revenue Code makes its own classification and prescribes its own standards of classification. * * * The term "corporation" is not limited to the artificial entity usually known as a corporation, but includes also an association, a trust classed as an association because of its nature or its activities, a joint-stock company, an insurance company,

See also Treasury Regulations 111, Section 29.3797-3 (Appendix, *infra*). On familiar principles these Treasury Regulations continued without substantial change and applying to unamended or substantially reenacted statutory language are deemed to have received congressional approval and to possess the force

and certain kinds of partnerships. (See sections 29.3797-2 and 29.3797-4.) The definitions, terms, and classifications, as set forth in section 3797, shall have the same respective meaning and scope in these regulations.

SEC. 29.3797-2. *Association.*—The term "association" is not used in the Internal Revenue Code in any narrow or technical sense. It includes any organization, created for the transaction of designated affairs, or the attainment of some object, which, like a corporation, continues notwithstanding that its members or participants change, and the affairs of which, like corporate affairs, are conducted by a single individual, a committee, a board, or some other group, acting in a representative capacity. It is immaterial whether such organization is created by an agreement, a declaration of trust, a statute, or otherwise. It includes a voluntary association, a joint-stock association or company, a "business" trust, a "Massachusetts" trust, a "common law" trust, an "investment" trust (whether of the fixed or the management type), an interinsurance exchange operating through an attorney in fact, a partnership association, and any other type of organization (by whatever name known) which is not, within the meaning of the Code, a trust or an estate, or a partnership. If the conduct of the affairs of a corporation continues after the expiration of its charter, or the termination of its existence, it becomes an association.

* * * * *

SEC. 29.3797-4. *Partnerships.*—The Internal Revenue Code provides its own concept of a partnership. Under the term "partnership" it includes not only a partnership as known at common law, but, as well, a syndicate, group, pool, joint venture, or other unincorporated organization which carries on any business, financial operation, or venture, and which is not, within the meaning of the Code, a trust, estate, or a corporation. On the other hand the Code classifies under the term "corporation" an association or joint-stock company, the members of which may be subject to the personal liability of partners. If an organization is not interrupted by the death of a member or by a change in ownership of a participating interest during the agreed period of its existence, and its management is centralized in one or more persons in their

of law. *Morrissey* v. *Commissioner,* 296 U.S. 344, 355-356; *Taft* v. *Commissioner,* 304 U.S. 351, 357; *Helvering* v. *Winmill,* 305 U.S. 79, 83; *Boehm* v. *Commissioner,* 326 U.S. 287, 291-292, rehearing denied, 326 U.S. 811.

Furthermore, the Supreme Court afforded authoritative construction of the governing statutory language

representative capacities, such an organization is an association, taxable as a corporation. As to the characteristics of an association, see also sections 29.3797-2 and 29.3797-3. The following examples will illustrate some phases of these distinctions:

(1) If A and B buy some acreage for the purpose of subdivision, they are joint adventurers, and the joint venture is classified by the Code as a partnership.

(2) A, B, and C contribute $10,000 each for the purpose of buying and selling real estate. If A, B, C, or D, an outside party (or any combination of them as long as the approval of each participant is not required for syndicate action), takes control of the money, property, and business of the enterprise, and the syndicate is not terminated on the death of any of the participants, the syndicate is classified as an association.

SEC. 29.3797-5. *Limited Partnerships.*—A limited partnership is classified for the purpose of the Internal Revenue Code as an ordinary partnership, or, on the other hand, as an association taxable as a corporation, depending upon its character in certain material respects. If the organization is not interrupted by the death of a general partner or by a change in the ownership of his participating interest, and if the management of its affairs is centralized in one or more persons acting in a representative capacity, it is taxable as a corporation. For want of these essential characteristics, a limited partnership is to be considered as an ordinary partnership notwithstanding other characteristics conferred upon it by local law.

The Uniform Limited Partnership Act has been adopted in several States. A limited partnership organized under the provisions of that Act may be either an association or a partnership depending upon whether or not in the particular case the essential characteristics of an association exist.

SEC. 29.3797-6. *Partnership Associations.*—A partnership association of the type authorized by the statutes of several States, such, for instance, as those of the State of Pennsylvania (Purdon's Penna, Stat. Ann., (Perm. Ed.), Title 59, ch. 3), having by virtue of the statutory provisions under which it was organized, the characteristics essential to an association within the meaning of the Internal Revenue Code, is taxable as a corporation.

and expounded the principles which must here control in its leading decision in *Morrissey* v. *Commissioner,* 296 U.S. 344, *supra,* and three companion cases (*Swanson* v. *Commissioner,* 296 U.S. 362; *Helvering* v. *Combs,* 296 U.S. 365; and *Helvering* v. *Coleman-Gilbert,* 296 U.S. 369).[5]

The *Morrissey* case emphasizes that (p. 357):

> The inclusion of associations with corporations implies resemblance; *but it is resemblance and not identity.* (Italics supplied.)

Both the Tax Court majority (R. 683) and the minority (R. 695-696) cite this proposition and agree that similarity, not identity, of a given business organization with corporations constitutes the basic test.

Moreover, instantly the issue may further be narrowed, for on the face of taxpayers' own contentions the business enterprise here indisputably meets two basic corporate criteria, namely, (1) association in a common enterprise, and (2) for the purpose of carrying on a business (frequently debatable points where the issue is classification of a trust as an association). See *Morrissey* v. *Commissioner, supra,* pp. 356-361; *Bloomfield Ranch* v. *Commissioner,* 167 F. 2d 586 (C.A. 9th), certiorari denied, 335 U.S. 821; Treasury Regulations 111, Sec. 29.3797-3. Taxpayers' insistence below and the Tax Court's findings, that the limited partnership constituted a real business enterprise in

[5] The controlling holdings in these Supreme Court cases also constitute the source of essential provisions of the Treasury Regulations cited in the preceding paragraph and which, indeed, often paraphrase the language of those opinions. *United States* v. *Homecrest Tract, supra,* p. 153.

which all the limited partners were joined, also serve to satisfy at least these tests of corporate resemblance. (R. 681, 692.)

Indeed, the instant situation finds accurate description in a pertinent article by Lloyd M. Smith, entitled "Associations Classified As Corporations Under the Internal Revenue Code, 34 Calif. L. Rev. 461, 482 (1946):[6]

> It seems perfectly clear that wherever there is a sufficient community of interest to satisfy the partnership test, there is certainly enough community of interest to constitute a "joint enterprise"; and in that event, whether the organization is to be taxed as a partnership or as a corporation will depend upon whether or not the particular arrangement satisfies the third basic test of the *Morrissey* case, namely, substantial resemblance to a corporation.

3. The business enterprise, Western Construction Company, obtained, through agreement of the parties participant, the essential organizational advantages of incorporation, and accordingly the mandate of the statute requires that the income of the enterprise be taxed in the same manner as that of corporations

To adopt the language of the *Morrissey* case (p. 359):

> What, then, are the salient features of a trust [family limited partnership]—when created and maintained as a medium for the carrying on of a

[6] Mr. Smith's article has already been noticed in an opinion of this Court. *United States* v. *Homecrest Tract, supra*, p. 152, fn. 3.

> business enterprise and sharing its gains—which may be regarded as making it analogous to a corporate organization?

The Supreme Court there listed (p. 359) five such "salient features", namely (1) title in a single entity; (2) centralized management; (3) continuity; (4) transferability of beneficial interests; (5) limitation of personal liability. Accordingly, let us proceed to examine the organizational framework of taxpayer, Western Construction Company, as found by the Tax Court here upon undisputed facts, in the light of these five indicia held by the highest authority to constitute typical factors of corporate resemblance, and repeatedly employed by this Court and the several Courts of Appeals in resolving issues similar to that at bar.

(1) *Title in a single entity.* The *Morrissey* case states (p. 359):

> A corporation, as an entity, holds the title to the property embarked in the corporate undertaking.

This factor is of significance only in its practical and not in its technical aspect. By hypothesis, an "association" taxable as a corporation is not a legal entity and, hence, technical title need not be vested in it. Title in the case of a trust, for example, may be divided among the trustees and beneficiaries, and, in the case of a partnership, such as here, technically held by the parties in the forms of claims against each other, or as joint tenants or tenants in partnership, as the case may be, dependent on local law. Essentially, the test under this factor of corporate resemblance is whether the organizational form affords the advantages of capacity,

s a unit, to acquire, hold, and dispose of property, and o deal with its property separate from the property f the individual associates. Surely, taxpayer Western Construction Company satisfied this standard of corpoate resemblance for instantly there was a clear disinction between the property held by Western Contruction Company and that belonging to the individual artners. (For example, the limited partnership ertificate itself referred to "partnership property" Art. XI, R. 668) and see Sec. 9972 of the Washington tatute (10 Remington's Revised Statutes of Washington, Annotated (Appendix, *infra*)), pursuant to which he limited partnership was formed.)

Indisputably Western Construction Company was in position and indeed did acquire, hold, and dispose of he partnership property in a practical sense, separate from its members' individual property. As the Court of Appeals for the Eighth Circuit held in *Nee* v. *Main Street Bank,* 174 F. 2d 425, 432, certiorari denied, 338 U.S. 827:

> The holding of title, as an element of resemblance to a corporate undertaking, is of significance here only in its practical and not in its technical aspect. That the beneficiaries intended to vest the trustees with title is plain; the trustees furthermore held the property; and the beneficiaries took a conveyance from them when the trust was terminated.

Where the separate property of the business organization is recognized and it may deal with its property as an entity, the fact that it does not hold legal title to the property is not controlling, as this Court held in *Commissioner* v. *Fortney Oil Co.,* 125 F. 2d 995, 998.

(2) *Centralized management.* The governing Treasury Regulations 111, Section 29.3797-5, (Appendix, *infra*), provide that a limited partnership may be classified as an "ordinary partnership" or as an "association taxable as a corporation", depending upon certain "material" characteristics. Moreover, "For want of these essential characteristics, a limited partnership is to be considered as an ordinary partnership notwithstanding other characteristics conferred upon it by local law." Again, one of these "essential" characteristics is specified as "the management of its affairs * * * centralized in one or more persons acting in a representative capacity". This language is also substantially repeated by the Regulations in connection with the classification of partnerships, other than limited partnerships, as associations. See Treasury Regulations 111, Sec. 29.3797-4 (Appendix, *infra*). Certainly, in a typical common law partnership, each member is an equal manager and agent of the partnership with every other. *Poplar Bluff Printing Co.* v. *Commissioner,* 149 F. 2d 1016, 1019 (C. A. 8th). On the other hand, in limited partnerships, typically management is centralized in the general partners. In any event, instantly the limited partnership certificate explicitly provides that "The entire management of the partnership shall be vested in the three General Partners * * * " (par. X, R. 668), as against the seven limited partners in 1942 (R. 665) and the ten limited partners for the remaining tax years (R. 673).[7]

[7] To avoid unnecessary repetition record reference in this discussion will usually be made only to the first limited partnership certificate, since the terms of the second limited partnership cer-

This indicia of centralized management is also one of the features mentioned in the *Morrissey* case (p. 359) and, of course, is analogous in corporate organization to management by a board of directors.

However, in *Glensder Textile Co.* v. *Commissioner,* 46 B.T.A. 176, *supra,* upon whose authority, as already noted, the Tax Court majority here relied (R. 686-687), it was held that the limited partnership there did not satisfy the characteristic of centralized management, as follows (p. 185):

> There was centralized control by the general partners, but this fact did not make them analogous to directors of a corporation. They were acting in their own interest as hitherto, which constituted five-twelfths of the partnership, and not merely in a representative capacity for a body of persons having a limited investment and a limited liability.

On the other hand, we submit that this holding is not well founded for reasons aptly expressed by Mr. Smith in the Law Review article already cited, whose criticism we adopt, as follows (Associations Classified As Corporations Under the Internal Revenue Code, 34 Calif. L. Rev. *supra,* pp. 517-518):

> The foregoing quotation seems to confine the idea of representative management within unreasonably narrow limits. It is difficult to see why any significance should be attached to the fact that the managers of the enterprise owned an interest in the business. In many cases either the local law or the

tificate dated June 30, 1943, as found by the Tax Court (R. 673), were substantially identical with the first limited partnership certificate dated February 24, 1942. The second certificate was admitted in evidence as Petitioner's Exhibit No. 3, and is printed in full in the record (R. 231-237).

> articles of incorporation require directors to own stock in the corporation. They still operate in a manner distinctly different from democratic management by all the owners, and they act largely in a representative capacity. Many trusts have been classified as corporations although the trustees owned a substantial beneficial interest in the enterprise, and in these cases the courts had no doubt that the attribute of centralized management was present.

In the instant family association the father managers obviously acted in a representative capacity in handling their sons' and daughters' investments, which taxpayers insist the children actually subjected to the risks of the business.

Again, the *Glensder* case (p. 185) points out that there, as appears equally true here, the limited partners were not able to remove the general partners and control them in the manner in which stockholders may control directors. It is submitted that this ground is equally unsound, for even prior to the *Morrissey* case, *Hecht* v. *Malley,* 265 U.S. 144, explicitly held that an unincorporated organization may be classified as a corporation although the beneficial owners had no right to select or remove the managers. Moreover, the *Morissey* case, following *Hecht* v. *Malley, supra,* again held that control by beneficiaries, such as is commonly exercised by stockholders in a business corporation, is not essential to the existence of a taxable association. (Pp. 352-353, 358-359.) To the same effect are *Helvering* v. *Combs, supra,* p. 368; *Helvering* v. *Coleman-Gilbert supra,* pp. 372-377; and the decision of this Court in *Commissioner* v. *Vandegrift R. & Investment Co.,*

supra, p. 390. See also Treasury Regulations 111, Sec. 29.3797-3.

As a corollary, significant resemblance to action by directors does not lie in formalities of meetings or records, in seals, by-laws or minutes, or that the acts of the managers are or are not determined by majority vote. *Morrissey* v. *Commissioner, supra,* p. 358; *Helvering* v. *Coleman-Gilbert, supra,* p. 373.[8]

In summary, the significant resemblance to action by directors does not depend upon the source of the power to appoint or remove them or the formalities of meeting or records but in the circumstance that the frame of the organization secures the centralized management of its affairs through designated representatives for the conduct of the business as a joint enterprise.

(3) *Continuity.* The remaining "essential" characterisitc for a limited partnership taxable as a corporation, stated in the controlling Regulations, is expressed in the alternative as follows (Appendix, *infra*):

> Sec. 29.3797-5. * * * If the organization is not interrupted by the death of a general partner

[8] Thus, Treasury Regulations 111, Sec. 29.3797-3, making an analogous distinction between an association and a trust reads (Appendix, *infra*):

> * * * The effectiveness in action in the case of a trust or of a corporation does not depend upon technical arrangements or devices such as the appointment or election of a president, secretary, treasurer, or other "officer," the use of a "seal," the issuance of certificates to the beneficiaries, the holding of meetings by managers or beneficiaries, the use of a "charter" or "by-laws," the existence of "control" by the beneficiaries over the affairs of the organization, or upon other minor elements. They serve to emphasize the fact that an organization possessing them should be treated as a corporation, but they are not essential to such classification, for the fundamental benefits enjoyed by a corporation, as outlined above, are attained, in the case of a trust, by the use of the trust form itself.

> *or* by a change in the ownership of his participating interest, * * * it is taxable as a corporation. (Italics supplied.)

Instantly, the organization, Western Construction Company, clearly satisfies this requirement.

Indeed, the Tax Court explicitly found that the limited partnership was the result of years of thought by the general partners directed to the end that the business would continue uninterrupted by the death or retirement of the general partners. Thus, the Tax Court found as follows (R. 676):

> The limited partnership was not the result of an impulse set off by the desire to minimize taxes, but rather the result of many years of thought by the general partners who were anxious to have their sons, daughters, and sons-in-law come into the business so that *it would continue after the general partners retired or died.* (Italics supplied.)

At the time of the formation of the limited partnership, the ages of the general partners were: J. A. Johnson, 64; George Johnson, 62; Albin Johnson, 52. (R. 219.) Typical in support of the quoted Tax Court finding is the testimony of J. A. Johnson on direct examination (R. 219):

> Q. Did or did not Roy Johnson's going with Kuney have any part in your intentions to form this limited partnership?
>
> A. Well, we formed the limited partnership with the intention that we would be able to keep these boys with us and continue the business. We realized, both George and myself, that we were getting pretty well up in age and we were in hopes that our

families could stick together and keep on the business.

Again, the testimony of two of the limited partners, Roy Johnson, son of J. A. Johnson (R. 416-417), and Winston Johnson, son of the general partner, Albin Johnson (R. 447-448), both on direct examination, for example, confirmed this purpose, in organizing the limited partnership, of building up a permanent family association. Thus, at the hearing, which it is noted, was had in 1948, Roy Johnson said "we could build a larger *company* and carry forward to larger projects" (italics supplied) (R. 417), and Winston Johnson was even more explicit (R. 448):

> I have always dreamed of the Western Construction Company being probably one of the largest construction *companies* in the Northwest, and we have always done large work, and we have gotten a good name for ourselves, and *I could not see why we could not continue this,* the three boys with the help from their sisters and the husbands of their sisters, and even though those husbands, like Mr. Ellingson, worked for us as a foreman, even in that capacity the fact that he was in the family and had an interest in the *company,* would be better for him and better for the *company* than other men that just were working for wages and had no other interest. And I still foresee in the future that the three boys and myself and the rest of us are going to continue in this type of work, and I still have got ambitions about this *company* becoming something again. (Italics supplied.)

The limited partnership certificate signed by all of the parties was carefully framed to carry out this long

cherished design of assuring the organizational advantage similar to that possessed by corporations, that the business "would continue after the general partners retired or died." (R. 676.) Thus, an absolute term for ten years was provided during which "the partnership shall exist". (Par. V, R. 667); (par. VII, R. 667.) Under the controlling Washington statute (10 Remington's Revised Statutes of Washington, Annotated, Sec. 9974, Appendix, *infra*), these provisions inhibited dissolution of the partnership upon, for example, retirement of a general partner, without the written consent of all of the general and limited partners in a notice of such dissolution, subscribed by all of them, filed with the original certificate and published in the same manner and for the time prescribed for the publication of the original certificate.[9] The similarity of this procedure for dissolution of the association by certificate filed and published publicly to the procedure commonly prescribed for voluntary dissolution of corporations is obvious.

Moreover, the identical paragraph (X) of the limited partnership certificate which, as already discussed, vested the "entire management" of the partnership in the three general partners, further provided (R. 668):

> the right is hereby given to the remaining General Partners to continue the business upon the death or retirement of a General Partner, and the right is also given to the General Partners to continue the business upon the death or retirement of any of the Limited Partners hereto.

[9] Namely, for four consecutive weeks. Secs. 9968 and 9969 of the Washington statute. (Appendix, *infra*.)

Whether or not technically upon the death or retirement of a general partner, a new partnership would arise and the old partnership dissolve seems unimportant and only a matter of metaphysics in the present context. Under this certificate the right is given for the business to continue, i.e., an organization is created which, like a corporation, need not be interrupted, wound up, or liquidated upon the death or retirement of either a general or a limited partner.

Moreover, the power to continue the business after the death or retirement of a general partner, which the right expressed in paragraph X of the agreement conferred, was in clear implementation of the basic purpose of the general partners to that end, which, as already seen, the Tax Court found as the fact. (R. 676.) Indeed, to carry out this fundamental design, such a specific agreement was necessary to prevent dissolution upon the death or retirement of either a general or a limited partner. *Ames* v. *Downing,* 1 Bradford 321, 325-333 (N.Y.); 2 Rowley, Modern Law of Partnership, Sec. 1035, p. 1411 (1916). Similarly, under the Uniform Limited Partnership Act, enacted in 1945 in Washington though not applicable to taxpayer during the taxable years (Remington's Revised Statutes of Washington, Annotated, (1945 Supp.), Sec. 9975-30 (2)), a general partner has no authority to continue the business with partnership property on the death or retirement of another general partner, unless the right so to do is expressly given in the limited partnership certificate. Sec. 9975-9 (1) (g) and Sec. 9975-20. Thus, the rule under the controlling Washington statutes is

clearly the same as that stated in the Regulations, with respect to limited partnerships organized under the Uniform Limited Partnership Act, namely, here as under the Uniform Act (Sec. 29.3797-5):

> A limited partnership * * * may be either an association or a partnership depending upon whether or not in the particular case the essential characteristics of an association exist.

The deliberate moulding of the organizational frame of the instant enterprise assured the existence in this "particular case" of "the essential characteristics of an association", as specified in the cited Regulations and the other authorities.

Contractual arrangements are not uncommon under which surviving partners continue an enterprise without liquidation, operating it for the benefit of themselves and the decedent's beneficiaries. The property of the deceased member remains subject to the risks of the business, but limited to the decedent's interest in the business as it existed at the time of his death. Such an arrangement is particularly appropriate in the case of a family partnership, where the deceased brother might be expected to possess confidence in the ability and integrity of the surviving general partner brothers, and where the beneficiaries of the deceased estate would in all likelihood be identical with some of the limited partners, namely, his children. Cases illustrating such agreements are *Stearns* v. *Brookline,* 219 Mass. 238; *Wild* v. *Davenport,* 48 N.J.L. 129; *Brew* v. *Hastings,* 196 Pa. 222; dicta in *Scholefield* v. *Eichelberger,* 7 Pet. 586, 594; *Burwell* v. *Mandeville's Executor,* 2 How. 559,

576. For a careful exposition, analysis and statement of the binding effect of such agreements, citing precedents, see Warner Fuller, Partnership Agreements for Continuation Of An Enterprise After the Death Of A Partner, 50 Yale L.J. 202, 204, 211 (1940).[10]

There is no reason to suppose that the law of Washington differs although direct authority is lacking. Cf. *In re Randle's Estate,* 29 Wash. 2d 447, 456-457, 188 P. 2d 71, which approved an agreement enabling a partnership to continue and affording the surviving partner the right to purchase the interest of a deceased partner at a fixed or determinable price.

The continuity of an organization without interruption by death is insured when the terms of the enterprise are binding upon an investor's successors, heirs, representatives, and assigns. *Bloomfield Ranch* v. *Commissioner, supra,* p. 592. In *Wabash Oil & Gas Ass'n* v. *Commissioner, supra,* p. 660, an association formed to operate an oil and gas lease was to continue during the term of the lease and it was provided that no party was entitled to dissolution but on the death or bankruptcy of any one, his personal representative or trustee in bankruptcy should succeed to his interest. See

[10] In a footnote the author of the cited article suggested that, whether arrangements of this type in a given case result in an "association", "presents an important tax problem." (P. 204, n. 10.) Without discussion he briefly indicated his view that this tax question had not then been decided, but that it seemed to have been assumed that a partnership exists where the members operate their business along orthodox lines and further, even if the arrangement is regarded as an association, appreciable tax savings (other than federal income tax) can be afforded through elimination of formal incorporation. Only pre-*Morrissey* authorities were referred to; the *Morrissey* case and the controlling Regulations were apparently not considered.

also *Poplar Bluff Printing Co.* v. *Commissioner, supra,* p. 1019.

Taxpayers may argue that paragraph X of the certificate merely affords the surviving partners the right to continue the business upon partial liquidation, namely, upon paying off the interest of a deceased partner, as in *In re Randle's Estate, supra,* which, here in the case of a deceased general partner, might amount to one-sixth. However, similar arrangements are not uncommon in the case of closed corporations upon the decease of a stockholder, and do not involve termination of the business, but only decrease in the capital. Further, the power conferred under paragraph X of the certificate need not be construed to be so limited, but, on the contrary, to comprehend the broader type of continuing arrangement, entailing no liquidation, as described above.

In any event, the proposition is well established that, for the purpose of determining whether an organization constitutes an association, where parties operate under an instrument their relationship is governed by the powers conferred by the instrument rather than by what the parties may have thought or even have done. *Wholesalers Adjustment Co.* v. *Commissioner,* 88 F. 2d 156, 157 (C.A. 8th).

Thus, recently, in *United States* v. *Homecrest Tract, supra,* p. 152, this Court held, citing and following the *Morrissey* case, as follows:

> The test is whether the trust deed discloses an association of individuals for the purpose of carrying on a business. This is to be determined from

> the trust instrument itself—from what *could be done* under the trust and *not from what is done.*

The character of an association is determined not by the extent to which the powers in the fundamental instrument organizing it have actually been exercised, but rather by the purposes and potentialities disclosed by that instrument on its face. *Morrissey* v. *Commissioner, supra,* pp. 360-361. It cannot escape taxation by declining to exercise powers which the instrument of its creation permits. *Helvering* v. *Coleman-Gilbert, supra,* pp. 373-374; *Commissioner* v. *Vandegrift R. & Inv. Co., supra,* p. 390; *Bert* v. *Helvering,* 92 F. 2d 491, 493 (C.A. D.C.); *Sears* v. *Hassett,* 111 F. 2d 961, 962-963 (C. A. 1st); *Second Carey Trust* v. *Helvering,* 126 F. 2d 526, 528 (C.A. D.C.), certiorari denied, 317 U.S. 642; *Porter* v. *Commissioner,* 130 F. 2d 276, 280 (C.A. 10th); *Pennsylvania Co. for Insurances, Etc.* v. *United States,* 138 F. 2d 869, 974 (C.A. 3d), certiorari denied, 321 U.S. 788; *Commissioner* v. *City Nat. Bank & T. Co.,* 142 F. 2d 771, 775 (C.A. 10th), certiorari denied, 323 U.S. 764; *Nee* v. *Main Street Bank,* 174 F. 2d 425, 429 (C.A. 8th).

We submit the Tax Court minority was here correct in pointing out that in *Glensder Textile Co.* v. *Commissioner, supra,* decided in 1942 prior to the Supreme Court decisions in *Commissioner* v. *Tower,* 327 U.S. 280, and *Lusthaus* v. *Commissioner,* 327 U.S. 293, the Board of Tax Appeals (R. 693-694)—

> was not confronted by the juxtaposition of a developed family partnership rule with the similarity of limited family partnerships to corpora-

> tions, and hence it cannot be regarded as controlling this question. It is for that reason, at least, less persuasive than a more recent decision of this Court holding certain family limited partnerships to be taxable as corporations. *Giant Auto Parts, Ltd.,* 13 T.C. 307.

Instantly, by agreement the parties here obtained the advantages of corporate similarity, which the Ohio statute in the cited case of *Giant Auto Parts* v. *Commissioner,* 13 T.C. 307, afforded the family limited partnership association there involved.

As already seen, the instant certificate provides that the partnership is to exist for ten years. (Par. V, VII, R. 667.) Cf. *Helm & Smith Syndicate* v. *Commissioner, supra,* p. 441, where although a single beneficiary might revoke a trust, each beneficiary had agreed to twenty-five years continuance. A trust frequently is provided to continue during the life of named persons or until the death of the last surviving trustee or settler. See *Commissioner* v. *Vandegrift R. & Inv. Co.,* 82 F. 2d 387, 389 (C.A. 9th); *Reynolds* v. *Hill,* 184 F. 2d 294 (C.A. 8th). Thus, even though all three general partners should die prior to the expiration of its ten year period, still reasonable continuity of the business is guaranteed for that period, amounting to three lives in being or ten years, and similar to the duration defined in business trust cases.

(4) *Transferability of beneficial interest.* By the agreement of the parties set forth in the limited partnership certificate large transferability of partnership interest was obtained in this business enterprise sub-

tantially similar to that commonly obtained in close family corporations. Thus, here, under paragraph XII of the certificate, it was provided (R. 668-669):

> The interests of all the Limited Partners herein may be transferred upon the approval of the General Partners to accept a new assignee as a Limited Partner in this co-partnership, and not otherwise.

In addition, pursuant to paragraph IX (R. 668):

> The General Partners are hereby given the right to admit additional Limited Partners in the future upon the agreement of the General Partners hereto, but in no event other than upon a cash contribution to the partnership, and upon the same terms as herein expressed.

Again, the provisions of the partnership certificate had the further effect of enabling the associates to avoid winding up and to continue the business even despite transfer of his interest by a general partner. This was a further consequence of paragraph X (R. 668) discussed, *supra,* since paragraph X empowered the remaining general partners to continue the business upon the retirement of a general partner and the attempt by a general partner to transfer his interest would effect his retirement as a general partner.

In this connection, Mr. Smith, in Associations Classified as Corporations, 34 Calif. L. Rev., *supra,* p. 533, states:

> Reasonable restrictions on the transfer of corporate stock are both lawful and common, but it seems that any absolute prohibition against all transfers of stock would be void as against public

> policy, at least under all normal conditions. This requires the conclusion that reasonable restrictions on the transfers of beneficial interests in an unincorporated enterprise are not very important; but it would not be unreasonable to hold that a "spendthrift trust", which contains an absolute and inescapable prohibition against transfers of beneficial interests, is so unlike both the law and the practice of corporations that it should not be classified as a corporation for purposes of taxation.

In *Wholesalers Adjustment Co.* v. *Commissioner,* 88 F. 2d 156, *supra,* p. 157, an unincorporated organization was held taxable as a corporation where the beneficial interest could not be transferred unless the managing partner consented. In *Pennsylvania Co. for Insurances, Etc.* v. *United States, supra,* p. 873, the beneficiaries of the trust might assign their interest, but the assignees must be approved by the trustee. (Cf. paragraph XII of the instant certificate.) See also *Wabash Oil & Gas Ass'n* v. *Commissioner, supra,* where although a subscriber might sell his interest, it was provided that he first must give the managing agents an opportunity to buy the interest for the benefit of the other subscribers.

Certainly here in view of the clear design to perpetuate this close family business within the family after the general partners retired or died (R. 676), reasonable transferability was provided substantially identical to that frequently obtaining in formally incorporated close family businesses. Accordingly on this factor, too, the instant organization satisfied the corporate resemblance test. Returning once more to the

est provided in the alternative by the governing Treasury Regulations (Sec. 29.3797-5), as a matter of law, he instant "organization is not interrupted by the eath of a general partner *or* by a change in the ownership of his participating interest". (Italics supplied.)

(5) *Limitation of Personal Liability.* The liability f the special partners is here, of course, limited to the mount of their investment, as in the case of stockolders. The liability of the general partners is unimited. However, it has frequently been held that comlete limitation of liability is not an indispensable haracteristic for corporate resemblance. So this Court eld in *Helm & Smith Syndicate* v. *Commissioner, upra,* p. 441, as follows:

> Petitioner claims and respondent denies that the liability of each beneficiary is that in a partnership. Even if so, limitation of the beneficiary's liability is not a *sine qua non* of the corporate analogy.

To the same effect are *Bert* v. *Helvering, supra,* p. 495; *Poplar Bluff Printing Co.* v. *Commissioner, supra,* p. 019; *Nee* v. *Main Street Bank, supra,* p. 432, and Section 29.3797-4 (Appendix, *infra*) of the controlling Treasury Regulations.

In summary, the combined attributes of corporate esemblance here present clearly support the conclusion f the minority opinion below, as follows (R. 695-696):

> In fact, if the general partners are thought of as common stockholders, and the special partners as holders of participating preferred stock, the entire arrangement would be identical in all respects with a corporate structure, except for the

> unlimited liability of the general partners. Since it is similarity and not identity which constitutes the test, *Morrissey* v. *Commissioner,* and since it is the interest of the special partners, and not that of the general partners, which raises the real present issue on both alternative contentions, it seems to me inescapable that this arrangement fails on the one hand to bear any resemblance to a true and actual partnership of all the participants, see Hill, Judge, dissenting in John A. Morris, 13 T.C. . . . (Dec. 21, 1949), but that on the other, it does resemble and almost duplicates a corporation, and that reality thus requires the tax to be imposed upon it as a corporation and not as a partnership.

D. *Special provisions of Washington law add to the corporate likeness of Western Construction Company*

In *State Ex Rel. Range* v. *Hinkle,* 126 Wash. 581, 219 Pac. 41, the Supreme Court of Washington quoting the state constitution, expressed the issue there before it as follows (p. 583):

> Section 5, of art. 12, of the state constitution, relating to corporations other than municipal, provides:
>
> "The term 'corporation' as used in this article, shall be construed to include all associations and joint stock companies having any powers or privileges of corporations not possessed by individuals or partnerships, and all corporations shall have the right to sue and shall be subject to be sued in all courts in like cases as natural persons."
>
> The question then arises whether or not this common law trust is an "association having powers

and privileges of corporations not possessed by individuals and partnerships."

The court, answering the question thus posed in the affirmative, said (p. 584):

> Under constitutional provisions similar to § 5, art. 12, *supra,* it is almost uniformly held that joint stock companies and limited partnerships organized under statutory authority are in fact corporations.

Moreover, instantly the minority opinion below points out that the nomenclature employed in the statute, under whose authority the instant limited partnership was organized, resembles and is appropriate for corporate organization. (R. 695.) Thus, the Washington statute under which taxpayer "company" was formed, repeatedly refers to the capital of the enterprise as common stock" and "capital stock". 10 Remington's Revised Statutes of Washington, Annotated, Sections 9967, 9968, 9972, 9973. (Appendix, *infra.*) Again, similar to the almost universal corporate provision, this statute prescribes that (Sec. 9972):

> * * * no part of the capital stock thereof shall be withdrawn, nor any division of interests be made, so as to reduce such capital stock below the sum stated in the certificate of partnership before mentioned; and if at any time during the continuance or at the termination of such partnership, the property or assets thereof are not sufficient to satisfy the partnership debts, then the special partners shall be severally liable for all sums or amounts by them in any way received or with-

> drawn from such capital stock, with interest thereon from the time they were so received or withdrawn respectively.

Also resembling common corporate provision is the prescription of Section 9968 that the basic certificate shall contain "the amount of capital which each special partner has contributed to the common stock".

While, as the minority opinion below also points out (R. 695), this statutory nomenclature is not decisive, nevertheless, it adds further support to the Commissioner's contention that this business enterprise closely resembles and has obtained the organizational advantages of incorporation, and should, therefore, be classified as an association and placed in the same tax category as corporate organizations of essentially the same character, regardless of formal technicality.

III

Alternatively, Western Construction Company Fails to Bear any Resemblance to an Actual Partnership of Which the Limited Partners Were Component Members

As already discussed in Point 1, *supra,* the instant Point III is presented in the alternative. Thus, in the event the Court holds in accord with the Commissioner's contention that Western Construction Company is taxable as a corporation (Point II, *supra*), the instant Point III is not reached for consideration.

The Commissioner's position, in accord with that expressed by the minority opinion below, is that, as already noted (Point I, *supra*), the issue of the reality of the limited partnership and the resemblance of the enterprise to a corporation cannot be neatly severed.

(R. 693.) Thus, if the limited partners (resembling preferred stockholders) are not associated with the general partners (resembling common stockholders) in an enterprise taxable as a corporation, then the so-called limited partners are not actual participants in the business at all. (R. 696.) Their role is then merely that of partial assignees of their respective fathers' income and the so-called limited partnership is taxwise —so far as the children are concerned—merely an arrangement for anticipatory assignment of income. Under the rule of the *Tower* and *Lusthaus* cases, *supra,* and of *Commissioner* v. *Culbertson,* 337 U.S. 733, the fathers' income thus anticipatorily assigned to the children is taxable to the respective assignor fathers.

In the *Tower* case a purported family limited partnership also was involved. The Supreme Court said (pp. 290-292):

> It is the command of the taxpayer over the income which is the concern of the tax laws. *Harrison* v. *Schaffner,* 312 U.S. 579, 581, 582. And income earned by one person is taxable as his, if given to another for the donor's satisfaction. *Helvering* v. *Horst,* 311 U.S. 112, 119. It is for this reason, among others, that we said in *Helvering* v. *Clifford, supra,* 335, that transactions between husband and wife calculated to reduce family taxes should always be subjected to special scrutiny. For if under circumstances such as those now before us, the end result of the creation of a husband-wife partnership, though valid under state laws, is that income produced by the husband's efforts continues to be used for the same business and family purposes as before the partnership, failure to tax it as the

> husband's income would frustrate the purpose of 26 U.S.C. § 22 (a). By the simple expedient of drawing up papers, single tax earnings cannot be divided into two tax units and surtaxes cannot be thus avoided.
>
> * * * * *
>
> The wife again took no part in the management or operation of the business. If it be said that as a limited partner she could not share in the management without becoming a general partner the result is the same. No capital not available for use in the business before was brought into the business as a result of the formation of the partnership. And the wife drew on income which the partnership books attributed to her only for purposes of buying and paying for the type of things she had bought for herself, home and family before the partnership was formed.

True, a finding of the Tax Court on the reality of a partnership is essentially a fact finding (*Commissioner* v. *Culbertson, supra,* pp. 741-742), subject to the "clearly erroneous" rule. However, as recently expressed by the Court of Appeals for the Tenth Circuit in *Maytag* v. *Commissioner,* decided March 21, 1951 (C.C.H., Federal Estate and Gift Tax Reporter, par. 10,800)—

> [a Tax Court] finding must be treated as clearly erroneous if based upon substantial error in the proceeding, if unsupported by any substantial evidence, if contrary to the clear weight of all the evidence, or if supported by evidence but the court of appeals in reviewing the entire evidence entertains the definite and firm conviction that a mistake has been committed.

Instantly, the underlying facts are not in contest, and if the relationship of the so-called limited partners to the enterprise is not as a consequence of its undisputed organizational form taxwise, as a matter of law under the statute, Regulations and authorities, that of stockholders to a corporation, then the finding of the Tax Court majority that the parties formed a bona fide partnership and really and truly intended to join together for the purpose of carrying on a partnership business (R. 681) is clearly erroneous as unsupported by any substantial evidence, as contrary to the clear weight of all the evidence, or if regarded as having support in the evidence, then on review by this Court of the entire evidence it is clear the fact finder was mistaken.

The record is replete with indicia that the parties did not intend to join together with a business purpose in the conduct of a partnership. The Tax Court found that the daughters did not render any services to the limited partnership of any substantial consequence (R. 678), and while the sons contributed engineering skill, which the general partners lacked, of substantial value to the partnership (R. 691), such services, as they did perform, were in part at odd hours and in addition to regular employment elsewhere (R. 676-678), and were under the direction of the general partners (R. 681). On the whole there was no change in the operation or management of the business after the formation of the limited partnership (R. 680-681), which, as before, remained under the direction of the three fathers.

Furthermore, the limited partners made their cash contributions to the partnership with money they borrowed from their respective fathers. The fathers drew checks on moneys they had to their credit on the books of Western Construction Company and delivered these checks to their children and in return each child gave his or her promissory note payable to the father. Each limited partner then gave the limited partnership a check in the amount of the loan in payment of his or her limited partnership interest.[11] Thus the partnership itself did not by this transaction increase its assets. The only net result was that each of the general partners had in his possession $20,000 worth of notes signed by his children.

The conclusion of the Tax Court that the possession of these notes was a factor of considerable importance to the financial status of the general partners and through them to the limited partnership, seems clearly erroneous (R. 689-690), in view, among others, of the undisputed finding that the notes were never pledged as collateral for any loan, but were merely listed as personal assets of the general partners in application for construction bonds (R. 671). Indeed, J. A. Johnson, one of the general partners, on cross examination could not even remember whether the bonding company

[11] When the three additional daughters were brought in as purported limited partners in 1943, none of the new partners made a direct or additional contribution of capital to the partnership. The new parties merely obtained a division of the interest which had been held in the name of brothers or sisters, who already were limited partners. This was accomplished by the unpaid notes of the latter partners being returned to them by their fathers and new notes being given aggregating the same amount as the original notes. (R. 674-675.)

ever looked at the notes. (R. 251.) The notes were all for short terms not exceeding two years, except in two cases when they were payable in yearly instalments of not less than $3,500 in any one payment. (R. 675.) Nevertheless, they appeared not to have been paid when due. Some were paid in 1945, one in 1946, two in 1947, and one had not been paid at the time of the hearing in 1948, despite the credit of large partnership profits to the children.

All the foregoing factors indicate that the so-called partnership contribution lacked economic reality and did not constitute substantial evidence of real intent to join in a partnership venture.

That the addition of the $60,000 in notes to the individual assets of the general partners was actually not a factor of considerable importance to their financial status, that the Tax Court was clearly erroneous in so finding, and that the net transaction between the fathers and the children amounted to nothing more than the drawing up of papers, is further evidenced by the circumstance that at the time the limited partnership was created Western Construction Company had well under way two large government contracts upon which gross profits were reflected in the first year of the limited partnership in amounts exceeding in the aggregate $436,000, which resulted in the crediting of profits to each partner including the limited partners of more than three and a half times his capital account. (R. 260, 604-607, 675-676.) George Johnson, one of the general partners, testified at the time the limited partnership was created in February, 1942, 40% of the Quartermaster contract upon which over $234,800 gross profit

was eventually realized, had already been completed, and the Rainier Vista contract, upon which eventually nearly $202,000 gross profit was realized, was between 25% and 30% completed. (R. 604-607.) The total cost of each of these contracts was eventually between a million and a quarter dollars and a million and a half dollars. (R. 606-607.) In view of the foregoing, it seems clear error for the Tax Court to have found that the $60,000 credit, which the children contributed in this unusual and circuitous manner, was of any substantial importance to the financial status of the business or of the general partners.

Additionally, in view of the pending profits on the partially completed government contracts, the granting of a one half share in the whole enterprise in return for the children's notes given under the circumstances above described, surely lacked business reality as a genuine partnership proposition.[12]

Finally, while some of the limited partners withdrew their shares of the profits, the majority actually did not withdraw a great deal of their profits, as the Tax Court found. (R. 690-691.) Besides, substantial amounts of the withdrawals appear to have been used merely to pay federal income taxes on the profits (which otherwise would have been payable by the general partners at higher surtax rates). See Resp. Ex. H. (R. 591-596.)

For similar reasons limited partnerships were not recognized for tax purposes in *Stanback* v. *Robertson,*

[12] The partnership profits credited to each child are set forth in the statements .(Pet. Exs. 12 (R. 379); 15 (R. 429); 16 (R. 460); 20 (R. 494); 21 (R. 522); 22 (R. 529); 23 (R. 539); 26 (R. 563); 27 (R. 565); 28 (R. 567).

183 F. 2d 889 (C.A. 4th), certiorari denied, 340 U.S. 904; and in the clear opinion of Judge Yankwich in *Toor* v. *Westover,* 94 F. Supp. 860 (S.D. Calif.), where the principles governing the instant issue are stated and applied. Cf., on the other hand, *Lamb* v. *Smith,* 183 F. 2d 938 (C.A. 3d), in which a jury verdict, sustaining a limited partnership, was under scrutiny and, hence, the scope of review was more limited than here, where the fact finding may be set aside for clear error.

CONCLUSION

For the reasons above given, the decisions of the Tax Court are erroneous and should be reversed.

Respectfully submitted,

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MAY, 1951.

Internal Revenue Code:

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

(1) *Person.*—The term "person" shall be construed to mean and include an individual, a trust, estate, partnership, company, or corporation.

(2) *Partnership and Partner.*—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

(3) *Corporation.*—The term "corporation" includes associations, joint-stock companies, and insurance companies.

(26 U.S.C. 1946 ed., Sec. 3797.)

10 Remington's Revised Statutes of Washington, Annotated:

CHAPTER 1

LIMITED PARTNERSHIPS

§ 9966. *Limited partnership may be formed.* Limited partnership for the transaction of mercantile, mechanical, or manufacturing business may be formed within this state, by two or more persons, upon the terms and subject to the conditions contained in this chapter.

§ 9967. *Of whom composed, and liability of members.* A limited partnership may consist of two or more persons, who are known and called general partners, and are jointly liable as general partners now are by law, and of two or more persons who shall contribute to the common stock a specific sum in actual money as capital, and are known and called special partners, and are not personally liable for any of the debts of the partnership, except as in this chapter specially provided.

§ 9968. *Certificate to be made, acknowledged and filed.* The persons forming such partnership shall make and severally subscribe a certificate, in duplicate, and file one of such certificates with the county auditor of the county in which the principal place of business of the partnership is to be. Before being filed, the execution of such certificate shall be acknowledged by each partner subscribing it, before some officer authorized to take acknowledgments of deeds, and such certificate shall contain the name assumed by the partnership and under which its business is to be conducted, the names and respective places of residence of all the general and special partners, the amount of capital which each special partner has contributed to the common stock, the general nature of the business to be transacted, and the time when the partnership is to commence, and when it is to terminate.

§ 9969. *False Statement—Publication of copy.*. Such partnership cannot commence before the filing of the certificate of partnership, and if a false statement is made in such certificate, all the persons subscribing thereto are liable as general partners for all the debts of the partnership. The partners shall, for four consecutive weeks immediately after the filing of the certificate of partnership, publish a copy of the same in some weekly newspaper, published in the county where the principal place of business of the partnership is, or if

no such paper be published therein, then in some newspaper in general circulation therein, and until such publication is made and completed, the partnership is to be deemed general.

§ 9970. *Renewal of limited partnership.* A limited partnership may be continued or renewed by making, acknowledging, filing, and publishing a certificate thereof, in the manner provided in this chapter for the formation of such partnership originally, and every such partnership, not renewed or continued as herein provided, from and after the expiration thereof according to the original certificate, shall be a general partnership.

§ 9971. *Name of firm—When special liable as general partner.* The business of the partnership may be conducted under a name in which the names of the general partners only shall be inserted, without the addition of the word "company" or any other general term. If the name of any special partner is used in such firm with his consent or privately, he shall be deemed and treated as a general partner, or if he personally makes any contract, respecting the concerns of the partnership, with any person except the general partners, he shall be deemed and treated as a general partner in relation to such contract, unless he makes it appear that in making such contract he acted and was recognized as a special partner only.

§ 9972. *Withdrawal of stock and profits—Effect of.* During the continuance of any partnership formed under this chapter no part of the capital stock thereof shall be withdrawn, nor any division of interests be made, so as to reduce such capital stock below the sum stated in the certificate of partnership before mentioned; and if at any time during the continuance or at the termination of such partnership, the property or assets thereof are not sufficient to satisfy the part-

nership debts, then the special partners shall be severally liable for all sums or amounts by them in any way received or withdrawn from such capital stock, with interest thereon from the time they were so received or withdrawn respectively.

§ 9973. *Suits by and against limited partnership—Parties.* All actions, suits, or proceedings respecting the business of such partnership shall be prosecuted by and against the general partners only, except in those cases where special partners or partnerships are to be deemed general partners or partnerships, in which case all the partners deemed general partners may join therein; and excepting also those cases where special partners are severally liable on account of sums or amounts received or withdrawn from the capital stock, as provided in the last preceding section.

§ 9974. *Dissolution, how may be accomplished.* No dissolution of a limited partnership shall take place, except by operation of law, before the time specified in the certificate of partnership, unless a notice of such dissolution, subscribed by the general and special partners, is filed with the original certificate of partnership, or the certificate, if any, renewing or continuing such partnership, nor unless a copy of such notice be published for the time and in the manner prescribed for the publication of the certificate of partnership.

§ 9975. *Liabilities and rights of members of firm.* In all cases not otherwise provided for in this chapter, all the members of limited partnerships shall be subject to all the liabilities and entitled to all the rights of general partners.

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.3797-1. *Classification of Taxables.*—For the purpose of taxation the Internal Revenue Code makes

its own classification and prescribes its own standards of classification. Local law is of no importance in this connection. Thus, a trust may be classed as a trust or as an association (and, therefore, as a corporation), depending upon its nature or its activities. (See section 29.3797-3.) The term "partnership" is not limited to the common law meaning of partnership, but is broader in its scope and includes groups not commonly called partnerships. (See section 29.3797-4.) The term "corporation" is not limited to the artificial entity usually known as a corporation, but includes also an association, a trust classed as an association because of its nature or its activities, a joint-stock company, an insurance company, and certain kinds of partnerships. (See sections 29.3797-2 and 29.3797-4.) The definitions, terms, and classifications, as set forth in section 3797, shall have the same respective meaning and scope in these regulations.

SEC. 29.3797-2. *Association.*—The term "association" is not used in the Internal Revenue Code in any narrow or technical sense. It includes any organization, created for the transaction of designated affairs, or the attainment of some object, which, like a corporation, continues notwithstanding that its members or participants change, and the affairs of which, like corporate affairs, are conducted by a single individual, a committee, a board, or some other group, acting in a representative capacity. It is immaterial whether such organization is created by an agreement, a declaration of trust, a statute, or otherwise. It includes a voluntary association, a joint-stock association or company, a "business" trust, a "Massachusetts" trust, a "common law" trust, an "investment" trust (whether of the fixed or the management type), an interinsurance exchange operating through an attorney in fact, a partnership association, and any other type of organization (by

whatever name known) which is not, within the meaning of the Code, a trust or an estate, or a partnership. If the conduct of the affairs of a corporation continues after the expiration of its charter, or the termination of its existence, it becomes an association.

SEC. 29.3797-3. *Association Distinguished from Trust.*—The term "trust," as used in the Internal Revenue Code, refers to an ordinary trust, namely, one created by will or by declaration of the trustees or the grantor, the trustees of which take title to the property for the purpose of protecting or conserving it as customarily required under the ordinary rules applied in chancery and probate courts. The beneficiaries of such a trust generally do no more than accept the benefits thereof and are not the voluntary planners or creators of the trust arrangement. Even though the beneficiaries do create such a trust, it is ordinarily done to conserve the trust property without undertaking any activity not strictly necessary to the attainment of that object.

As distinguished from the ordinary trust described in the preceding paragraph there is an arrangement whereby the legal title to the property is conveyed to trustees (or a trustee) who, under a declaration or agreement of trust, hold and manage the property with a view to income or profit for the benefit of beneficiaries. Such an arrangement is designed (whether expressly or otherwise) to afford a medium whereby an income or profit-seeking activity may be carried on through a substitute for an organization such as a voluntary association or a joint-stock company or a corporation, thus obtaining the advantages of those forms of organization without their disadvantages. The nature and purpose of a cooperative undertaking will differentiate it from an ordinary trust. The purpose will not be considered narrower than that which is formally set forth in the

instrument under which the activities of the trust are conducted.

If a trust is an undertaking or arrangement conducted for income or profit, the capital or property of the trust being supplied by the beneficiaries, and if the trustees or other designated persons are, in effect, the managers of the undertaking or arrangement, whether the beneficiaries do or do not appoint or control them, the beneficiaries are to be treated as voluntarily joining or cooperating with each other in the trust, just as do members of an association, and the undertaking or arrangement is deemed to be an association classified by the Internal Revenue Code as a corporation. However, the fact that the capital or property of the trust is not supplied by the beneficiaries is not sufficient reason in itself for classifying the arrangement as an ordinary trust rather than as an association.

By means of such a trust the disadvantages of an ordinary partnership are avoided, and the trust form affords the advantages of unity of management and continuity of existence which are characteristic of both associations and corporations. This trust form also affords the advantages of capacity, as a unit, to acquire, hold, and dispose of property and the ability to sue and be sued by strangers or members, which are characteristic of a corporation; and also frequently affords the limitation of liability and other advantages characteristic of a corporation. These advantages which the trust form provides are frequently referred to as resemblance to the general form, mode of procedure, or effectiveness in action, of an association or a corporation, or as "quasi-corporate form." The effectiveness in action in the case of a trust or of a corporation does not depend upon technical arrangements or devices such as the appointment or election of a president, secretary, treasurer, or other "officer," the use of a "seal,"

the issuance of certificates to the beneficiaries, the holding of meetings by managers or beneficiaries, the use of a "charter" or "by-laws," the existence of "control" by the beneficiaries over the affairs of the organization, or upon other minor elements. They serve to emphasize the fact that an organization possessing them should be treated as a corporation, but they are not essential to such classification, for the fundamental benefits enjoyed by a corporation, as outlined above, are attained, in the case of a trust, by the use of the trust form itself. The Internal Revenue Code disregards the technical distinction between a trust agreement (or declaration) and ordinary articles of association or a corporate charter, and all other differences of detail. It treats such a trust according to its essential nature, namely as an association. This is true whether the beneficiaries form the trust or, by purchase or otherwise, acquire an interest in an existing trust.

The mere size or amount of capital invested in the trust is of no importance. Sometimes the activity of the trust is a small venture or enterprise, such as the division and sale of a parcel of land, the erection of a building, or the care and rental of an office building or apartment house; sometimes the activity is a trade or business on a much larger scale. The distinction is that between the activity or purpose for which an ordinary strict trust of the traditional type would be created, and the activity or purpose for which a corporation for profit might have been formed.

SEC. 29.3797-4. *Partnerships.*—The Internal Revenue Code provides its own concept of a partnership. Under the term "partnership" it includes not only a partnership as known at common law, but, as well, a syndicate, group, pool, joint venture, or other unincorporated organization which carries on any business, financial operation, or venture, and which is not, within

the meaning of the Code, a trust, estate, or a corporation. On the other hand the Code classifies under the term "corporation" an association or joint-stock company, the members of which may be subject to the personal liability of partners. If an organization is not interrupted by the death of a member or by a change in ownership of a participating interest during the agreed period of its existence, and its management is centralized in one or more persons in their representative capacities, such an organization is an association, taxable as a corporation. As to the characteristics of an association, see also sections 29.3797-2 and 29.3797-3. The following examples will illustrate some phases of these distinctions:

(1) If A and B buy some acreage for the purpose of subdivision, they are joint adventurers, and the joint venture is classified by the Code as a partnership.

(2) A, B, and C contribute $10,000 each for the purpose of buying and selling real estate. If A, B, C, or D, an outside party (or any combination of them as long as the approval of each participant is not required for syndicate action), takes control of the money, property, and business of the enterprise, and the syndicate is not terminated on the death of any of the participants, the syndicate is classified as an association.

SEC. 29.3797-5. *Limited Partnerships.*—A limited partnership is classified for the purpose of the Internal Revenue Code as an ordinary partnership, or on the other hand, as an association taxable as a corporation, depending upon its character in certain material respects. If the organization is not interrupted by the death of a general partner or by a change in the ownership of his participating interest, and if the management of its affairs is centralized in one or more persons acting in a representative capacity, it is taxable as a corporation. For want of these essential character-

istics, a limited partnership is to be considered as an ordinary partnership notwithstanding other characteristics conferred upon it by local law.

The Uniform Limited Partnership Act has been adopted in several States. A limited partnership organized under the provisions of that Act may be either an association or a partnership depending upon whether or not in the particular case the essential characteristics of an association exist.

SEC. 29.3797-6. *Partnership Associations.*—A partnership association of the type authorized by the statutes of several States, such, for instance, as those of the State of Pennsylvania (Purdon's Penna. Stat. Ann., (Perm. Ed.), Title 59, ch. 3), having by virtue of the statutory provisions under which it was organized, the characteristics essential to an association within the meaning of the Internal Revenue Code, is taxable as a corporation.

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No. 12,806

In the United States Court of Appeals for the Ninth Circuit

No. 12,806

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

WESTERN CONSTRUCTION COMPANY, RESPONDENT

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ALBIN JOHNSON, RESPONDENT

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ELLEN M. JOHNSON, RESPONDENT

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

HULDAH JOHNSON, RESPONDENT

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

GEORGE J. JOHNSON, RESPONDENT

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

J. A. JOHNSON, RESPONDENT

ON PETITIONS FOR REVIEW OF THE DECISIONS OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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ON PETITIONS FOR REVIEW OF THE DECISIONS OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

"QUESTIONS PRESENTED"

I. Whether the Limited Partnership Western Construction Company constituted an association taxable as a corporation.

II. In the alternative if Western Construction Company is held not to be taxable as a corporation then whether Western Construction Company was a partnership consisting only of the three general partners or, on the other hand, whether the Tax Court properly recognized the children of the three general partners as members of the firm in addition to their respective Fathers, the General partners.

The two questions above set forth are the questions presented in the brief of appellant on Page 5. Actually, the two questions were the questions when the matter was presented to the trial court. Since the trial court, the Tax Court of the United States, found, however, that the parties to the Limited Partnership agreement here involved formed a bona fide partnership and truly intended to join together for the purpose of carrying on the business as a partnership and that it was not an association taxable as a corporation (R. 681-682). Then the questions presented to this appellant court must be amended to read as follows:

I.

Was the Tax Court of the United States, the trial court herein, *clearly erroneous* in finding as follows: That the Limited Partnership, Western Construction Company, did not constitute an association taxable as a corporation and,

II.

Was the Tax Court of the United States, the trial court herein, *clearly erroneous* in finding that the parties to the Limited Partnership agreement here involved formed a bona fide partnership and truly in-

tended to join together for the purpose of carrying on the business as a partnership.

"SUMMARY OF ARGUMENT"

In general the appellee will follow the outline of the appellant's Brief in order to answer issue for issue the matters as they are raised by the appellant. However, the appellee wishes to point out in the very beginning that the Commissioner of Internal Revenue, the petitioner or appellant herein, stresses as his first question the contention that the Western Construction Company is an association and therefore taxable as a corporation. And, most of the argument in Petitioner's brief deals with this question. The fact that the trial court, The Tax Court of the United States, has definitely found that the respondents are a bona fide partnership is completely overlooked and ignored by Petitioner. Therefore, in the very beginning of Respondents' brief respondents wish to call to the attention of this court that a Limited Partnership is in itself an entity entitled to judicial respect. It is not just a collection of individuals in a scrambled category into which have been conveniently dumped all manners of trust, joint stock associations, voluntary associations, inter-insurance exchanges and many other organizations without definite entity, form or design. This court will take judicial recognition of the fact that a partnership is perhaps the oldest business entity composed of more than one individual known to the common law or even to more ancient jurisprudence. A Limited Partnership, of course, is a more modern modification of the ancient partnership. It exists in uniform statutory form in 32

states* of the Union and many of the remaining states will no doubt adopt it in the very near future.

We mention this historical background for the reason that the Petitioner deliberately ignores it, adulterating the meaning of partnership by following a definition that loosely construes a partner to be a member of a syndicate group, pool, joint adventure or organization. It will be noted, too, that with the exception of the *Glensder Textile Co. v. Commissioner*, 46 B.T.A. 176, case, that most of the cases, with few exceptions, are cases dealing with trusts of different kinds and not partnerships in the true sense of the word.

*See Uniform Laws Annotated, Vol. 8, 1950 Cumulative Annual Pocket Part.

At the very outset, therefore, of Respondent's brief, respondent wishes to call the court's attention to its own feeling for that dignified term of human participation in business which through the centuries is known as a "partnership," and which should have an integrity and respect all of its own. The feeling of this court was expressed in the *Bloomfield Ranch v. Commissioner* case reported in 167 F.(2d) 586 on Page 590 wherein Judge Garrecht speaking for the court said:

> "We do not think that the Federal Court in decisions involving the identity of an organization as a partnership under the Internal Revenue Code have wilfully ignored or denied the basic concept of a partnership under general principles of law."

Judge Garrecht goes on further to say:

> "Just as an 'association' has been defined to im-

> ply associates and entering into joint enterprise so does a partnership or joint enterprise imply an association and entering into a joint enterprise. *But the latter association conceives the intentional combination and joint endeavor of the parties interested in a common enterprise for their mutual benefit and not merely the appearance of combination or collection action by accident.*" Emphasis ours.

This court, also, in *Commissioner v. Gerstle*, 95 F. (2d) 587, stressed the same point and recognized the importance of intentional joint action and combination of efforts in the undertaking therein involved. Several years later Mr. Justice Frankfurter in a concurring opinion in *Commissioner v. Culbertson*, 337 U. S. 735, on Page 750, lead the way for many similar expressions that this court earlier stated as above mentioned.

While the Culbertson case is mainly cited in Petitioner's brief as setting forth a test for the bona fides of a partnership, nevertheless, Respondents believe that Mr. Justice Frankfurter's words are just as applicable to the first question here involved, to-wit: Whether the Limited Partnership Western Construction Company constituted an association taxable as a corporation and whether the trial court was clearly erroneous in determining that said Limited Partnership did not constitute an association taxable as a corporation.

We quote from Justice Frankfurter:

> "The court today reaffirms this reliance by its quotation from the Tower case. The final sentence the portion quoted underlines the fact that the

> court could not purport to announce a special concept of 'Partnership' for tax purposes differing from the concept that rules in ordinary commercial law cases. The sentence is: 'We see no reason why this general rule should not apply to tax cases where the Government challenges the existence of a partnership for tax purposes." 327 U. S. 287.

Justice Frankfurter goes on further to say, on page 753:

> "The need for guarding against misuse of the outward form of a partnership as a device for obtaining tax advantages is properly satisfied by reliance on the vigilance of the Tax Court, not by distorting the concept of partnership,"

and, on Page 754, Mr. Justice Frankfurter says this:

> "We should leave no doubt in the minds of the Tax Court, of the Courts of Appeal, of the Treasury and of the Bar that the essential holding of the Tower case is that there is no reason 'Why the general rule' by which the existence of a partnership is determined 'Should not apply in tax cases where the Government challenges the existence of a partnership for tax purposes.' "

The point respondents make is that the Petitioner in this case is trying to make a special concept of 'Partnership' for tax purposes, not alone in the test of the bona fides of the partnership but in this instance as refers to Question No. I in trying to dilute a partnership into an association. Chief Judge McGruger in the case of *Barrett v. Commissioner of Internal Revenue*, 185 F.(2d) 150, in a concurring opinion says:

> "So far as I can see this notion was utterly devoid of statutory basis (this so-called new con-

cept of a partnership for income tax purposes) as is apparent from a mere reading of Internal Revenue Code 181, 182 and 3797, 26 U. S. C. A. 181, 182, 3797. As I read Commissioner of Internal Revenue v. Culbertson, supra, the effect of that case is to sweep this earlier notion into the discard. This is more sharply pointed up perhaps in the concurring opinion by Mr. Justice Frankfurter, but the same viewpoint is discernable from a reading of the majority opinion as a whole. Thus the opinion of the court points out that the evidence in the particular case must be examined to determine whether it is 'Sufficient to satisfy ordinary concepts of partnerships.' " 337 U. S. at Page 739.

Again at (Id) 741, 742, quotes with approval what has been said in the earlier case of *Commissioner of Internal Revenue v. Tower*, 1946, 327, U. S. 280,

> "That when an issue is presented in an Income Tax case, as to whether a family partnership is real 'The inquiry must be whether the partners really and truly intended to join together for the purpose of carrying on business and sharing in the profits or losses or both, and their intention in this respect is a question of fact to be determined from testimony disclosed by their agreement considered as a whole and by their conduct at execution of its provisions." *Brennen vs. London Assurance Company*, 113 U. S. 51; *Cox vs. Hickman*, 8 H.L. CAS, 268. "We see no reason why this general rule should not apply in tax cases where the Government challenges the existence of a partnership for tax purposes."

The Judge concluded:

> "On the record as a whole it cannot be said that the Findings of Fact of the tax court was clearly erroneous."

Chief Justice Hughes in one of the cases most cited by Petitioners makes a sharp distinction:

> "They had been co-owners but they preferred to become associates and *also not to* become partners." *Guy T. Helvering, Commissioner v. Coleman-Gilbert Associates,* 296 U.S. 369. Emphasis ours.

The respondent cites these cases as support for its theory that The Commissioner in this case is trying to make a special concept of partnership for tax purposes to be termed an association taxable as a corporation.

Now that the Culbertson case has straightened out the matter of the true test of a partnership for tax purposes the Commissioner, respondents believe, is trying to form another special concept of partnership for taxation purposes, to-wit: that of an association taxable as a corporation, and the one important thing missing in the brief of the Commissioner, the appellant, is the fact that the Petitioner ignores that concept of a partnership as defined by Judge Garrecht, *supra.*

In other words, the dignity of the partnership entity itself.

ARGUMENT

Petitioner makes the following tests in deciding the question of whether this partnership has such a substantial resemblance to a corporation that it is taxable as such:

(a) Title vested in a single entity
(b) Centralized management
(c) Continuity
(d) Transferability of beneficial interest, and
(e) Limitation of personal liability.

But in reviewing these tests the respondents urge that this court look through the right glasses or, if you please, through the right end of the telescope. Since the Tax Court of the United States has found that there was a true bona fide partnership then unless the record shows that the Tax Court was clearly erroneous in making such a finding there is no question as to whether there was an association taxable as a corporation, because obviously, it is impossible to have a bona fide partnership and at the same time a loose association taxable as a corporation. We have either one or the other. In our argument, respondents propose to prove to this court that the Tax Court of the United States was not erroneous in any respect in making the findings that the Limited Partnership was a true partnership and was not an association taxable as a corporation. In respect to the association question, the respondents will show to this court that the partnerships in question had title to no property as a single entity; rather that the individuals in the partnership had title to all of the property. That the management was not centralized in one or more persons *acting in a representative capacity* as provided for by Treasury regulations in their test of whether or not a limited partnership is taxable as a corporation. Section 29. 3797-5 of the Internal Revenue Code. That there was

no continuity of the interests of any of the partners after either death or the term of the organization. That there was no transferability of beneficial interest as such transferability exists in a corporate structure and that there was no limitation of personal liabilty except in the very framework of the Limited Partnership Act itself and that only for the limited partners.

With respect to the bona fides of the partnership the respondents will show that the Limited Partnership here in question was not formed for the purpose of reducing taxes. On the contrary, the record discloses that the Limited Partnership was created for valid business purposes without any thought of tax savings. (R. 676.) The idea of forming a Limited Partnership by bringing in the adult members of their families was conceived by the three General Partners after a disastrous contract known as the Coulee Dam job where the three general partners had lost over $100,000.

> "The loss was approximately $100,000 which was all the money the partners had saved during the many years before. While the partners were not forced into bankruptcy they were deeply in debt having pledged their homes and all they owned to the bank and it was necessary that the bonding company complete the Coulee Dam contract." (R. 661.)

This part of the findings of the tax court was not included in the Statement of Facts of the Petitioner.

Argument Relating to Contention of Petitioner That Partnership Was Not a True One.

In the case of *Miller v. Commissioner of Internal Revenue*, 183 F. (2d) 246, in the Sixth Circuit, a state of facts existed that respondents urge was not nearly as bona fide as the present statement of facts. In that case the Petitioner made a gift of a half interest in a chain of drug stores to his wife. She had worked in the stores even before their marriage. The Petitioner and wife then created twelve trusts for equal benefit of three children. The Tax Court held there was no valid partnership for tax purposes, but the Circuit Court of Appeals reversed the tax court as to husband and wife, who were held to constitute a valid family partnership and the case was remanded for decision on question of trust interest established for the minor children. On page 252 the court reviewed the Culbertson Case, 327 U. S. 293, and said:

> "Assuredly this court on review does not weigh the evidence or pass upon the credibility of witnesses, those are the functions of the trier of the facts and for it alone. It is only when there is no substantial evidence to support the findings and decision or on errors of law that the reviewing court may act to set aside the decision of the Tax Court. We find, however, no substantial evidence to support the conclusions that Mrs. Miller was not the owner of a capital interest in the partnership."

Certainly the facts in the case at bar are much stronger in favor of the bona fides of a partnership than were those in the Miller case. Some of the more

recent decisions of the Circuit Court of Appeals on family partnership cases are as follows: *Crosley v. Campbell*, 184 F. (2d) 639, decided October 26, 1950, C.C.A. 7; Partnership entered into by plaintiff and plaintiff's son, was held to be a real bona fide partnership which should be recognized for tax purposes, even though the son was a student at the time, and not active in the business in electrical engineering. The partnership manufactured electrical and radio equipment. The Court said on Page 642, among other things:

> "This court stated in *Greenberger v. Commissioner*, 7th Circuit, 177 Fed. (2d) 990-994, the court in the Culbertson case left no doubt that the predominant factor is the good faith and the legitimate purpose of the parties in forming a partnership."

The court said:

> "The trial court's findings of good faith and legitimate purposes of plaintiff and his son in forming the partnership cannot be ignored or brushed aside. Surely such findings are not clearly erroneous. Under the test laid down in the Culbertson case we think the case was correctly decided by the District Court and judgment is affirmed."

In *Ginsburg, et ux, v. Arnold, et al*, reported in 185 F. (2d) 913, on December 21, 1950, C.C.A. 7, the father gave an interest to his son and two daughters, paid gift tax on transfers. The children did not contribute services to the partnership. The court said:

> "The finding by the trial court to the effect that this was a valid partnership between appellants

> and their children and others who might collaterally attack it but not for tax purposes, cannot be sustained. As Mr. Justice Frankfurter said in his concurring opinion in the Culbertson case, there is no 'Special concept of partnership for income tax purposes differing from the concept that rules in ordinary commercial law of cases.' A family partnership for income tax purposes is to be judged in the light of partnerships in general. A partnership is generally said to be created when persons joined together their money, goods, labor or skill for the purpose of carrying on a trade, business or profession when there is a community of interest in the profits or losses." See *Ward v. Thompson*, 22 Howard 330, 16 L. Ed. 249.

Respondent is citing and quoting from this case for the reason that the facts in this case seem to the respondent to be not nearly as strong as in the case at bar, in regard to the bona fides and the intent and purposes of the partners.

> On pages 915 and 916 * * *the court further said: "That none of the children contributed anything in the way of services, capital or influence to the business directly or indirectly."

The District court was reversed and the partnership held bona fide for income tax purposes.

The Respondent now cites a number of cases for the purpose of showing that there seems to be no divergent view to the rule that the determination of the Tax Court of the United States is conclusive in finding whether or not the partnership is a true partnership. *Cobb v. Commissioner of Internal Revenue*, 185 F.

(2d) 255, decided December 6, 1950, C.C.A. 7. The opinion in this case on Page 258 and 259 stated:

> "The want of substantial contribution to capital non-participation and management and control of the kind and character of contributed services may place a heavy burden on the taxpayer to show bona fide intent, but such determination is conclusive." Partnership recognized for tax purposes.

Cullamer v. Commissioner of Internal Revenue, 185 F. (2d) 146, C.C.A. 4, the court said:

> "The findings of the tax court may be disturbed if, but only if, these findings are clearly erroneous. Since we are unable to find that the decision of the tax court is clearly erroneous, that decision must be affirmed."

In the case of *Barrett v. Commissioner, supra,* the court said on Page 157:

> "In conclusion it will suffice to say that whether ostensible husband and wife partners really and truly intend to join together for the purpose of carrying on business * * * depends in each particular case upon all the pertinent facts; that under established principles this presents a question for the Tax Court in the first instance and that its answer there will not be disturbed unless clearly erroneous."

To same effect is the case of *Nelson v. Commissioner of Internal Revenue,* reported in 184 F.(2d) 649, C.C.A. 8.

It would seem, therefore, beyond dispute that the facts as found by the Tax Court of the United States in

the case at bar were not erroneous in any respect and that this Court should affirm the findings and decision of the trial court that the Limited Partnership was a bona fide and true partnership for tax purposes.

The Petitioner on Page 33 of his brief states:

> "Under such circumstances the finding of the Tax Court majority that all of the parties formed a bona fide partnership and intended to join together for the purpose of carrying on a business partnership is clearly erroneous."

In the face of the decisions just cited, the statement of the Petitioner would seem to be an unwarranted presumption and probably should not be dealt with at great length by respondent herein. Following Petitioner's brief here for a time, the assertion, on Page 33, that there is no change in the operation or management of the business after the formation of the limited partnerships would certainly later on in petitioner's brief seem to confound him when Petitioner claims that there was a representative management thereby making the partnership an association similar in that respect to a corporation. But what he means to imply by the statement at this point is obscure. He goes on to say that the daughters performed no services, and that such services that the sons performed were under the direction of the General Partners. If the intent of the partners in entering into the agreement were truly to form a partnership, certainly the fact as contended for by petitioner would not make any difference and has not made any difference in several cases above cited where the partners did not contribute services

or finances or anything else and the partnership was held to be a true partnership.

But, when appellant comes down to the notes given by the limited partners he gets into a peculiar position. He says that the notes given by the children were not owned or used by the partnership as such but constituted separate assets of the individual general partners to whom they were payable, which, of course, is a fact and should be remembered when petitioner makes his inconsistent argument a little later that limited partners gave nothing for their interest. But, Petitioner seems to ignore conveniently the matter of the use of these notes. The Tax Court found that the possession of these notes was a factor of considerable importance to the financial status of the general partners and through them to the Limited Partnership as Petitioner states again on Page 33 of his brief. But to show how these notes actually worked, we call attention to the testimony of J. A. Johnson (R. 263-264-265). The testimony was given on cross-examination and we think it worthwhile to put it in full in this brief as a footnote.*

*Q. And by doing that how would the partnership be richer after than they were before?

A. Well, we had $60,000.00 of notes in the partnership, and those notes were good.

Q. But those notes offset equal amounts which you credited to the individual limited partners, didn't they?

A. Well, we were just $60,000.00 better off after we had those notes than we were before. Even though it was not actually in cash, it was in notes, but we were $60,000.00 better off financially than we were before.

Q. You mean that you were better off or the partnership was?

A. The partnership was.

Q. But the notes were given to you individually, weren't they?

A. Yes, but when we signed for bonds and had a note in the bank—we were not in a corporation, you see, we were in a partnership, and

The Petitioner also contends on Page 33 of his brief that because two large Government contracts were partially completed when the limited partnership agreement was executed, that it was error for the Tax Court to have found that the $60,000 credit which the Limited Partners contributed by way of their notes was of any substantial importance to the financial status of the business or of the General Partners. If the Petitioner's counsel had had any experience in the contracting business, it would certainly appear pretty plain

when we signed on the dotted line, we signed everything away that we had.

Q. When you agreed to give your children some share of that for their notes, you took the same personally for what you gave them, isn't that correct?

A. Well, we still had the same capital.

Q. Now, what do you mean by that?

A. Well, I didn't pay them the cash. They owed me that $6,666 on a note, and I still had the same amount of capital that I had before.

Q. But they owed you that note personally. They didn't owe it to the partnership—your children didn't owe it to the partnership, did they?

A. They owed it to me personally, but I had to sign for the company. We were $60,000.00 better off on account of those notes.

Q. You mean you were, or the partnership?

A. The partnership.

Q. How was the partnership any better off? That is what I want to know.

A. We were $60,000.00 better off.

Q. The notes didn't belong to the partnership.

A. Yes, but—

Q. (interposing); now, wait a minute. You say "yes," but do you mean yes or no. The notes were yours, or were they the partnership's?

A. The notes belonged to me personally because I had borrowed the money personally, but when we came to get a loan, or for our financial purposes, it didn't make any difference whether it belonged to the partnership or whether it belonged to me personally. As a partnership we had to sign on the dotted line, on the notes, or on the bonds, or on any finances that we had to get, we had to sign for it, and we obligated all our capital or all our belongings together when we signed the note.

Q. You mean you, George and Albin did.

A. Yes, sir.

Q. And that was so because you were general partners, isn't that right?

A. Yes, sir.

Q. So when you went to get credit you used all your personal assets and resources in order to get it?

A. That is correct.

to them that about that time the partnership's limited assets would have been severely strained to carry on large contracts and while months later it might have been determined that a profit was made, until the profit was actually collected in the form of money out of retained percentages, etc., this court undoubtedly will take judicial recognition of the fact that carrying on two large contracts with the limited assets that this partnership had to begin with required every cent of money and every possible credit that the partnership could secure.

It will be remembered that the trial court found that on July 30, 1942, an additional $50,000 was borrowed from the bank (R. 670-671), and as J. A. Johnson testified, supra, these notes were used by the general partners in their financial statements for the purpose of obtaining credit. At the time the limited partnership was formed, the general partners owed the bank about $80,000. (R. 581.) While respondent doesn't want to go into the record too much, believing that the court findings are conclusive, nevertheless since Petitioner claims the trial court was clearly erroneous in the findings and cites the notes as an example, respondent wishes to refer to the testimony of Mr. Westly Ogg, Credit Manager for the Seaboard Branch of the Seattle-First National Bank. Mr. Ogg brought with him Petitioner's Exhibit No. 18 which he identified as a financial statement "given us and signed by Mr. J. A. Johnson as part of our confidential record files in support of any accommodation of credit, or otherwise he might request from us." Petitioner's Exhibit 18 shows

that item of $20,000 listed as accounts and notes due from friends and relatives. (R. 480-481.)

The fact that the notes weren't hypothecated is not material. They were used for the purpose of securing credit. If the bank having had enough confidence in the partnership to not require the notes be hypothecated, what difference does that make to the partnership if they obtained the necessary credit without the hypothecation? The fact that in the next year or at least several months later the aggregate profit exceeded $436,000 would not be material or a cause for deciding that the venture was not a bona fide partnership. As the trial court has pointed out

> "They knew that the construction business is subject to heavy losses as well as handsome profits." (R. 671-672.)

It would certainly be unfair to say that when a contract was 40 per cent completed that success was assured and the profits could be distributed on the basis of said 40 per cent completion. Respondent contends that the finding of the trial court that the Limited Partnerships were bona fide partnerships is sustained by all of the evidence and that there is nothing erroneous in the findings and that if the case were tried *de novo* that this court would make the same finding.

Therefore, respondents contend that the finding is conclusive and must be affirmed and if that be so then there is nothing further to be decided for the reason that if the limited partnership is a true and bona fide partnership that obviously this enterprise cannot be an association taxable as a corporation.

However, we will now take up that contention by Petitioner, but in doing so Respondent urges again that this court view the contentions of the Petitioner not from the end of the telescope that sees the pool or indefinite association but from the end of the telescope that visions "*the intentional combination and joint endeavor of the parties interested in the common enterprise for their mutual benefit*" has been formed and that the Tax Court of the United States has so found.

ARGUMENT RELATING TO CONTENTION OF PETITIONER THAT PARTNERSHIP WAS AN ASSOCIATION TAXABLE AS A CORPORATION

In Petitioner's summary of argument on page 20 of his brief, Petitioner states that the mandate of the statute as construed by the highest authority requires taxation of Western Construction Company as an association taxable as a corporation. He goes on to make the argument that this is a question of law and not a review of a question of fact. Respondent does not concede this. As the court said in *Wabash Oil & Gas Association v. Commissioner*, 160 F. (2d) 658, C.C.A. 1, decided in 1947 on Page 660:

> "There seems to be some divergence of views among the Circuits as to the nature of the question. In the Fifth Circuit it was held even before the decision in *Dobson v. Commissioner*, 320 U. S. 489, that the question was one of fact. * * * But in the Sixth and Ninth it seems to have been assumed without discussion that the question was one of law. *Commissioner v. Fortney*, 125 F.(2d) 995, *Helm and Smith Syndicate v. Commissioner*, 136 F.(2d) 440. * * *

However, neither in this case nor in any of the other cases cited by Petitioner had there been a *finding by the trial court* that the organization was *a true partnership*. This finding changes the viewpoint and must change it in this instant matter. Therefore, respondents insist again that there being no error in the finding of the Tax Court of the United States that Western Construction Company was a true partnership for taxation purposes, that, therefore, there is nothing further to argue, as to its corporate resemblance, if any. However, to meet the argument of Petitioner respondents contend that without the decision or finding of the trial court that the organization was a bona fide partnership, that, nevertheless, the additional finding by the trial court that the entity was not that of an association taxable as a corporation also must stand, unless the evidence supporting the finding is clearly erroneous, and respondent believes that it can easily and cogently show this court that there was no error in the finding.

In the case of *Commissioner v. Brouillard*, 70 F. (2d) Page 158, it is said:

> "Where an entity of this kind resembles a corporation in some respects and that of a partnership in others, that frequently being the case, the features of similarity should be compared and the marks of dissimilarity contrasted. The resemblances should be balanced, it should be determined by that method the one to which the enterprise is predominantly akin in the method, mode and form of procedure in the conduct of its business. If it be a corporation, it falls within that category; if

> a partnership it should be placed in that class and should be taxed accordingly."

This is what respondent means by looking into the right end of the telescope. In other words, the respondent believes that the balancing of the resemblances and the comparing of the dissimilarities should begin with the finding by the Tax Court that the particular partnership in this case has been held by the Tax Court to be a valid and true partnership. Therefore, that its dissimilarities to a corporation overbalance any small resemblances which it might have to a corporate structure. The respondent believes that these resemblances are very small and minor as will be pointed out later in this brief.

To begin with Petitioner has taken a Law Review article by one Lloyd M. Smith from the California Law Review, Volume 34, September, 1946, and has followed it very closely. There are many elements that Mr. Smith in a very intelligent, if not realistic, treatise has overlooked. For instance, the joint enterprise feature that respondent has emphasized several times in the first part of his argument. That feeling, as we suggested, that this court had for that warm relationship between persons who engage in a joint endeavor, as Judge Garrecht said:

> "An intentional combination and joint endeavor of the parties interested in a common enterprise for their mutual benefit."

Which joint enterprise, respondents sincerely urge is present in the combination of individuals signing the Articles of Copartnerships in the instant case. This

attitude, or what we have called feeling, is pointed up by a quotation from the testimony which Petitioner sets forth on Page 51 of his brief; that is, the testimony of Winston Johnson, one of the young limited partners, who, said among other things, that he always dreamed of the Western Construction Company being probably one of the largest construction companies in the Northwest. That they had done good work and had gotten a good name for themselves and they didn't see why they couldn't continue, the three boys with the help from their sisters and the husbands of their sisters and even through those husbands like Mr. Ellingson who worked for us as a foreman and he didn't see why in the future the three boys, himself and the rest of them, couldn't continue in this kind of work and he still had ambitions about the company becoming something again.

Petitioner, of course, italicized the use by Winston Johnson of the world *company*, meaning to take technical advantage of the use of that term by the young man and also to show that it would continue after the general partners retired or died. Of course, every member of this respected bench who might have a son while in the practice of law certainly could dream of having that son as a partner with him, and perhaps even a grandson, regardless of whether the first partnership might be terminated with the death of the grandfather and a new partnership by the same name continued in the name of the son and grandson. That is, of course, what was in the mind of this young dreamer, Winston Johnson, not a technical consideration of how the busi-

ness would be kept legally continuing. All through Mr. Smith's article and, of course, copied and emphasized by Petitioner, is a lack of practical consideration of partnerships as they exist in business throughout the United States today. Mr. Smith cites only one case involving a limited partnership and that is the *Glensder Textile Co. v. Commissioner*, 46 B.T.A. 176, and he lightly dismisses the limited partnership form. This respondents urge was a grave error on both Mr. Smith's and Petitioner's part. A form of business organization that is a modern refinement or modification of the original partnership law which in itself has become codified as a Uniform Limited Partnership Act and adopted by so many States of the Union is a living creature of our law and to have it thus lightly disregarded and adulterated into something else *called an association for taxation purposes* is to do exactly what Mr. Justice Frankfurter and Judge McGruder point out was done in the cases following those of *Commissioner v. Lusthaus*, 327 U. S. 293, and that was to form a new and, may we add, strange concept of a partnership.

Peculiarly enough, this was without logical foundation in the very cases that gave rise to the opportunity to form such a strange new concept as Justice Frankfurter pointed out when he said that there was no foundation in either the Lusthaus or Tower cases for this concept. And respondents urge that in *Morrissey v. Commissioner*, 296 U. S. 344; *Swanson v. Commissioner*, 296 U. S. 362; *Helvering v. Combs*, 296 U. S. 365, and *Helvering v. Coleman-Gilbert Associates*, 296 U. S. 369, all companion cases, with the opinions

written by Chief Justice Hughes, that there is not in these cases the basis for this new and unique concept of making a real Limited Partnership into an association taxable as a corporation. That the Commissioner, the Petitioner herein is trying in this case to springboard off the Morrissey case and its companion cases a new concept of tax law just as the Commissioner used the Lusthaus and Tower cases for an unfair base to assess the income of relatives in a partnership to the originator or main partner, simply because of the relationship in most instances. Respondents submit this new concept sought for by Petitioner is even more nebular and impractical than the former concept and much more inequitable and unfair than the concept the Commissioner strove for after the Tower and Lusthaus cases. For instance, in this case the Tax consequences would be as follows: If the partnership were held to be an untrue and unreal one the tax consequences of setting over the income of the limited partners to the general partners would be as set forth in the Footnote 2 on Page 35 of Petitioner's brief as follows: Albin Johnson, $123,675.85; Ellen Johnson, $38,-467.40; Huldah Johnson, $39,812.41; George J. Johnson, $38,828.50, and J. A. Johnson, $37,903.24, or a total of $278,687.40, while to find the partnership was an association taxable as a corporation would be to levy a confiscatory deficiency against these respondents in the sum of $728,832.16.

Therefore, let us look at the Morrissey and companion cases first. In the Morrissey case, supra, the trust was created for the development of a tract of land

through construction of a golf course, club house, with broad powers for purchase, operation and sale of the property. The centralized management was as the court held comparable to the Board of Trustees or Directors of a corporation and was, therefore, representative. The interest in the trust was evidenced by shares, preferred at $100 each, and common shares of no par value. There was provision for the assignment of certificates of interest, there was limitation of liability and continuity of management. It is obvious that its comparison or resemblance, as was said in the case, to a corporation was true in nearly every aspect.

In *Swanson v. Commissioner, supra,* a business trust by co-owners of apartment house property was set up. The receipts to evidence the interest of the beneficiaries representing 100 shares of the par value of $100 each might be transferred by assignment. The agreement provided that the trust could sue and be sued as such and neither the trustees nor the beneficiaries should be personally liable. The trust had succession, was not terminated by the death of a trustee or beneficiary.

In *Guy T. Helvering, Commissioner of Internal Revenue v. E. E. Combs, supra,* a trust was created to finance and drill one oil well and the production and sale of oil. The certificates of beneficial interest were to be issued in approved legal form. Quoting from Page 368 and 369,

> * * * "Entering into a joint undertaking they avoided the characteristic responsibilities of partners and secured advantages analogous to those which pertain to corporate organizations."

In the next companion case, that of *Guy T. Helvering v. Coleman-Gilbert Associates, supra,* five persons associated in owning and operating apartment houses, formed a trust to continue for 15 years. Quoting from Page 374 of the court's decision, Headnote 2:

> "* * * They formed a combination to conduct the business of holding, improving and selling real estate with provision for management through representatives with continuity which was not to be disturbed by death or changes in ownership of beneficial interest and with limited liabilities."

We now quote again the words of Chief Justice Hughes which we have used before:

> "*They had been co-owners but they preferred to become associates and also not to become partners.*" Emphasis ours.

Just a few months later, to-wit, in the October term, 1936, the Supreme Court of the United States decided another case involving a trust, the case: *A. A. Lewis v. Commissioner,* 301 U. S., Page 388-389. The court in its decision refers to the Morrissey and companion cases and said:

> "We pointed out that the corporate analogy was evidenced by centralized control, continuity and limited liability, as well as by the issue of transferable certificates and we said that the word 'association' implies associates. * * * There is to be found in the operation of the business (here) no essential characteristic of corporate control — nothing analogous to a Board of Directors or shareholders, no exemption of personal liability, no issue of transferable certificates of interest."

Petitioner does not mention this case in his brief but plainly the Supreme Court of the United States after deciding the Morrissey and companion cases did not intend that a new concept of taxation be launched from those cases and the Lewis case decided soon afterwards is a good signboard that the Court's reasoning in the Morrissey case is not to be extended into the nebulous unreality of the arguments proposed by Petitioner in his brief.

Taking up Petitioner's arguments as he advances them, beginning on Page 31 of his brief, we find him suggesting that a business enterprise which has obtained most of the organizational advantages of incorporation should be taxed as a corporation and that the legislative purpose was clearly to place in the same tax category business organizations essentially of the same character regardless of formal technicality.

Respondent believes that such a comprehensive grouping is altogether erroneous and dangerous. Clearly the legislatures of the different states that have adopted the Uniform Limited Partnership Act did not propose to place this partnership in the same income tax category as a corporation.

Then the Petitioner goes on to list four things which evidently he thinks are essential organizational advantages of incorporation. They are: That it possesses the capacity as a unit to acquire, hold and dispose of property and to deal with its property separate from its members' individual property. The statutes then in force in the State of Washington governing the organ-

ization of Limited Partnerships are listed in a footnote below.

It will be noted that there is no entity possible to be formed under the laws as set forth herein wherein this entity can own property as such, sell it, transfer it, deal in leases or have any other powers that a cor-

[1] R.R.S. 9966, 9967, 9968, 9971, 9973, 9975.

9966. Limited partnership may be formed. Limited partnership for the transaction of mercantile, mechanical, or manufacturing business may be formed within this state, by two or more persons, upon the terms and subject to the conditions contained in this chapter.

9967. Of whom composed, and liability of members. A limited partnership may consist of two or more persons, who are known and called general partners, and are jointly liable as general partners now are by law, and of two or more persons who shall contribute to the common stock a specific sum in actual money as capital, and are known and called special partners, and are not personally liable for any of the debts of the partnership, except as in this chapter specially provided.

9968. Certificate to be made, acknowledged and filed. The persons forming such partnership, shall make and severally subscribe a certificate, in duplicate, and file one of such certificates with the county auditor of the county in which the principal place of business of the partnership is to be. Before being filed, the execution of such certificate shall be acknowledged by each partner subscribing it, before some officer authorized to take acknowledgments of deed, and such certificate shall contain the name assumed by the partnership and under which its business is to be conducted, the names and respective places of residence of all the general and special partners, the amount of capital which each special partner has contributed to the common stock, the general nature of the business to be transacted, and the time when the partnership is to commence, and when it is to terminate.

9971. Name of firm—When special liable as general partner. The business of the partnership may be conducted under a name in which the names of the general partners only shall be inserted, without the addition of the word "company" or any other general term. If the name of any special partner is used in such firm with his consent or privately, he shall be deemed and treated as a general partner, or if he personally makes any contract, respecting the concerns of the partnership, with any person except the general partners, he shall be deemed and treated as a general partner in relation to such contract, unless he makes it appear that in making such contract he acted and was recognized as a special partner only.

9973. Suits by and against limited partnership—Parties. All actions, suits or proceedings respecting the business of such partnership shall be prosecuted by and against the general partners only, except in those cases where special partners or partnerships are to be deemed general partners or partnerships, in which case all the partners deemed general partners may join therein; and excepting also those cases where special partners are severally liable on account of sums or amounts received or withdrawn from the capital stock, as provided in the last preceding section.

9975. Liabilities and rights of members of firms. In all cases not otherwise provided for in this chapter, all the members of limited partnerships shall be subject to all the liabilities and entitled to all the rights of general partners.

poration possesses as one of its peculiar and necessary characteristics.

A Limited Partnership organized under the laws of the State of Washington as set forth in this brief cannot sue, even in the name of the limited partnership, or be sued as such.

(2) The Petitioner states: "Management of its affairs was centralized in the three general partners acting in a representative capacity." When Petitioner uses "representative capacity" he should be more exact because, obviously, general partners who are personally liable without limitation are not mere representatives of the limited partners and a close examination of the law as set forth in the footnote herein will show that in no sense could the general partners be termed representative. Treasury Regulations 3, Section 29, 3796-5 specifically mentions acting in a representative capacity. It states:

> * * * "If the management of its affairs are centralized in one or more persons acting in a *representative capacity*, it is taxable as a corporation. For want of these essential characteristics, a Limited Partnership is to be considered as an ordinary partnership * * *." Emphasis ours.

Now let us examine into this test of representative capacity. In a corporation the Directors or Trustees are elected for a stated term by the shareholders. This is, of course, the representative capacity meant by the Treasury Regulation. The permanent Edition of Words and Phrases, Volume 37, Page 66, under the phrase "acting in a representative capacity," cites the

case of *VanBrunt and Davis Company v. Herrigan et al*, Supreme Court of South Dakota, reported in 65 N.W. Page 422,

> "The contention of counsel for respondent that partners sued as such are sued in a representative capacity is not tenable. The term 'representative capacity' is a well-understood term and only applies to a party acting for and in behalf of some other party or estate and not for himself personally. When a party sues or is sued in such capacity, it is necessary that the capacity in which he sues or is sued should appear in the title to show the relation between the party and the estate representative and that he is in court not for himself but for the estate he represents. Partners occupy no such position, when suing or being sued they represent themselves only. Any judgment for or against them is rendered for or against them individually and not as a partnership."

This, of course, is exactly in line with the law of the State of Washington as set forth, *supra*. Then in Subdivision Three, Page 31 of his brief, Petitioner goes on,

> "By means of a special agreement and powers conferred in the Limited Partnership certificate continuity of the business was assured notwithstanding the death or the retirement of a general or limited partner."

While there was the following provision in the certificate of Limited Partnership, Petitioner prefers to ignore the law of the State of Washington in existence at the time governing the probate of partnership property. We set out the laws of the State of Washington

in footnote[2] below covering the probate of partnership property.

An examination of these statutes shows that the death of a partner terminates the partnership. No distinction is made between General and Limited Partner. The executor or administrator of the deceased partner is required to make a separate schedule in the

[2] R.R.S. 1458, 1459, 1460, 1461.

1458. Partnership property—Inventory—Rights of surviving partner. The executor or administrator of the estate of a deceased person who was a member of a copartnership, shall include in the inventory, in a separate schedule, the whole of the property of such copartnership; and the appraisers shall estimate the value thereof and also the value of such deceased person's individual interest in the partnership property.

The whole of the partnership property shall be administered by such executor or administrator, unless the surviving partners shall, within five days from the filing of the inventory, or such further time as the court may allow, apply for the administration thereof. If he so apply, he shall be entitled to administer the partnership property if the court find him to be qualified. If letters of administration be issued to such partner, he shall give such bond as the court may require. He shall be denominated the administrator of the partnership and shall give such notice to the partnership creditors as general administrators are required to give and shall settle the partnership estate in the same manner as is or shall be provided for the settlement of estates or deceased persons except he shall account to the general executor or administrator for the interest of the deceased in the partnership property.

1459. Purchase of interest by survivor—Protection against liabilities. The surviving partner, whether he be administrator or not, shall have the right at any time to petition the court to purchase the interests of such deceased in any or all the personal property of the partnership. Upon such petition being presented it shall be the duty of the court, in such manner as it may see fit, to learn and by order to fix the value of the interest of the deceased over and above all partnership debts and obligations, in such partnership personal property, and the terms and conditions upon which such surviving partner may purchase, and thereafter such surviving partner shall have the preference right for such length of time as the court may fix, to purchase the interest of such deceased partner at the price and upon the terms and conditions fixed by the court.

It shall be the duty of the court to make such orders as it may deem proper or necessary to protect the estate of the deceased against any liability for partnership debts or obligations.

1460. Survivor to operate business. The court shall have authority, in instances where it is deemed advisable, to authorize the administrator of the partnership property to continue to operate any going business pending the settlement of the partnership estate or the purchase by the surviving partner of the interest of the deceased partner.

1461. Survivor failing to act. In case the surviving partner is not appointed administrator of the partnership property, the administration thereof shall devolve upon the executor or administrator and the court shall have power to require the surviving partner to deliver the partnership property and evidence thereof to the administrator or executor.

inventory containing the whole of the property of such partnership. The surviving partnership is given five days from the filing of the inventory to apply for the administration thereof; the survivor is also given the right to purchase the interest of the deceased partner. Also, the court is to take the necessary steps to protect the estate of the deceased against any liability arising out of the partnership. The court has the authority to authorize the administrator of the partnership property to continue to operate any going business pending the settlement of the partnership estate or the purchase by the surviving partner of the interest of the deceased partner.

Therefore, under the laws of the State of Washington applicable to these limited partnerships upon the death of a general partner or of a limited partner, the partnership was automatically terminated. The best that provision X of certificate, printed in footnote, could give to the organization would be to give some time or period of grace while the court wound up the affairs of the partnership through its probate department or arrange for the purchase by a surviving partner of the interest of the deceased partner. This arrangement, however, would also terminate the partnership.

Appellant's brief on Page 53 goes on to state, "that under this certificate the right is given to the business

Provision X. The entire management of the partnership shall be vested in the three general partners and the right is hereby given to the remaining general partners to continue the business upon the death of retirement of a general partner and the right is also given to the general partners to continue the business upon the death or retirement of any of the Limited Partners hereto. (R. 665-669).

to continue, *i.e.* an organization is created which, like a corporation, need not be interrupted, wound up or liquidated upon the retirement of either a general or limited partner." Now there are authorities, and many of them, beginning with the *Morrissey* case and the companion cases, which hold that the parties' purpose in organizing "was no other than that they formally set forth in the instrument under which their activities were conducted and similar dicta." However, the mere fact that in Paragraph X of the Certificate of Limited Partnership the right is given to the remaining general partners to continue the business upon the death or retirement of a general partner or a limited partner does not mean, of course, that this right expressed in the contract is a *legal right* and if, under the law of the state in which the partnership is organized, no such right could be given, then the provision in the contract is invalid and an invalid covenant or portion of an agreement certainly can't be construed to be valid for tax purposes or any other purpose.

On Pages 54 and 55 of Appellant's brief this subject is discussed. But there is nothing in the discussion, although it existed by statute, *supra*, that shows to the court that the laws of the State of Washington are different than the ones cited and Appellant states on Page 55:

> "There is no reason to suppose that the law of Washington differs although direct authority is lacking."

We don't know why Petitioner put that statement in his brief when in the Respondent's brief in the Tax

Court the statutes of the State of Washington as set forth here were set forth there and the argument of respondent's was set forth in detail as it is here.

Petitioner cites *In re Randall's Estate*, 29 Wn.(2d) 447, on Pages 456-457, 188 P.(2d) 71, which approved an agreement enabling a partnership to continue affording the surviving partner the right to purchase the interest of a deceased partner at a fixed or determinable price. So states the Petitioner on Page 55, but he misleads the court when he says that the decision approved an agreement enabling a partnership to continue. This is true only so far as the partnership was continued under the agreement to purchase, similar to probate law, R.R.S. 1459, *supra*, and we quote the part of the statute controlling:

> "And thereafter such surviving partner shall have the preference right for such length of time as the court may fix to purchase the interest of such deceased partner at the price and upon the terms and conditions fixed by the court."

This gave to the surviving partner only the right to purchase the decedent's interest. It did not allow continuity of the joint venture and that is the misleading inference that Petitioner tries to draw.

In the *Randall Estate* case, *supra*, the Washington Supreme Court simply approved an agreement between partners whereby a surviving partner had the right to purchase the interest of a deceased or withdrawing partner at a price to be determined by a method agreed upon by contract between them. *The issue in the case was the price agreed upon. And whether a fraud had*

been perpetrated. Nowhere in the decision did it do other than uphold the agreement as to the right of a surviving partner to purchase the interest of a deceased partner. *It did not in any way give continuity to the partnership.* That question was not involved.

> ". . . there is no reason to suppose that the law of the State of Washington differs, although direct authority is lacking." . . . *Indeed!*

Petitioner on the next page runs into himself and admits in anticipation of this argument that the Respondents might argue that Paragraph X of the certificate merely affords the surviving partners the right to continue the business upon partial liquidation, namely, upon paying off the interest of the deceased partner. However, Petitioner again misleads the court because the court isn't informed of the probate law. There cannot be any valid argument that the business could continue upon partial liquidation. *The original partnership couldn't continue at all;* only for such time as might be necessary to liquidate the interest of the deceased or retiring partner. A new partnership with the survivors, if more than one, then begins or a sole proprietorship if only one survived.

Then Petitioner makes an argument that he makes in various parts of his brief that is very unusual in the light of his persistent demand that the court hold the partners to the agreement which they signed. Petitioner says, "similar arrangements are not uncommon in cases of closed corporations upon the decease of stockholders and do not involve termination of the business but only decrease in the capital." Of

course, this is the right of the directors and stockholders of a corporation to make contracts between themselves. The right of any stockholder or group of stockholders in any corporation to make agreements among themselves to dispose of their property, to-wit: the stock in the corporation. The corporation themselves in their Articles of Incorporation do not have provisions that provide for the liquidation of the corporation except term expiration and the corporation isn't in any way liquidated, suspended or dissolved upon the death of one of the stockholders, which is the case in partnerships and was the case in the State of Washington at the time of the limited partnership certificates in this case.

Then Petitioner goes on to say further that the power conferred under Paragraph X of the Certificate need not be construed to be so limited, but on the contrary to comprehend a broader type of continuing arrangement entailing no liquidation as described above. Petitioner knows better than this. Unenforceable covenants in agreements can give no powers that the law itself denies. This is too elementary to cite authorities.

On Page 55 of his brief, Petitioner recommends that the court read the Warner-Fuller Article re: "Partnership agreement for continuation of an enterprise after the death of a partner," in 50 Yale Journal, 202, 204, 211, (1940). The article is indeed interesting. On Page 205 the author speculates upon such an enterprise being continued by surviving partner without the introduction of a successor partner to replace decedent. He suggests that the contract is valid on ordinary con-

tract principles but further surmises that it is "unlikely that the courts will decree specific performance of such agreements. Equity ordinarily will not specifically enforce such contract which involve the exercise of special skills and judgment or demand constant supervision on the courts."

In Footnote 22 to the article the author goes on to say:

> "The reasons which have been advanced for denying specific performance of a partnership agreement among living partners seem to apply with equal force to the situation where a surviving partner is unwilling to continue the business after the death of an associate. It has been said that with respect to the former situation that equity will not enforce a contract requiring the exercise of the business skill and judgment so characteristic of the partnership relation. See *Buck vs. Smith*, 29 Mich. 161-171; *Clark vs. Truitt*, 183 Ill. 239, 245, 55 N. E. 683; 5 Pomeroy Equity Jurisprudence 4th Ed., 4898. If continuation of the business should become impractical for any reason continued performance on the part of the survivor probably would be excused on the theory that the presumed intent of the parties would be to wind up the enterprise in such circumstances even though the subscribed term had not yet expired. See *Clifps Estate*, 135 Mich. 4, 10 (1929) 23, 7 N. Y. Supp. 635, 643; Lindley, Partnership (10th Ed. 1935) 677.

The author in Footnote 10 goes on to say:

> " * * * It seems to have been assumed that a partnership and not an association exists where

> the members operate the business along orthodox partnership lines, although they may have agreed that the enterprise should be continued to the end of the agreed term despite the earlier death of a member."

Appellant then cites *Bloomfield Ranch vs. Commissioner, supra,* Page 592 and *Wabash Oil & Gas Association v. Commissioner,* 160 F.(2d) 658, Certiorari denied 331 U. S. 843; also cites *Poplar Bluff Printing Company vs. Commissioner,* 149 F. (2d) 1016 on the next page.

In the *Bloomfield Ranch v. Commissioner* case which we have cited for another purpose it was held in substance that the continuity of an organization without interruption by death is insured when the term of the enterprise is binding upon the investors, successors, heirs, representatives and assigns. That point, of course is not in the instant case, there being no such agreement whatever and there could not be a valid one under the Washington laws.

In the *Wabash Oil & Gas Association* case it was provided that no party was entitled to dissolution but on the death or bankruptcy of anyone his personal representative or trustee in bankruptcy should succeed to his interest.

On Page 661 in that case the courts said:

> "* * * Substantially resembled a corporation in its organization. That is to say, the Articles of Agreement secured centralized management, title to the property embarked in the undertaking as to the lease in an individual with provision for his

> succession and as to the equipment in a board of three 'Managers and agents' with provision for their succession, security from the termination of the enterprise by reason of the death of any beneficial owner; facility of transfer of the beneficial interest without affecting the continuity of the enterprise and limitation of the personal liability of the subscribers."

This, of course, is an entirely different situation than the limited partnerships in the case at bar. In the *Poplar Bluff Printing Company v. Commissioner* case, *supra*, the court has an interesting comment to make which we set forth herein:

> "In an ordinary copartnership each partner represents his fellows and within the scope of the common enterprise may by his acts impose liability upon them. When, however, the associates so organize themselves that no representation action may be taken normally except *by elected officials* the association has taken on qualities of a corporation as distinguished from a partnership," Emphasis ours.

The respondents suggest that this is an excellent analysis of the difference between the partnership as herein constituted and a representative management as is contained in a corporate structure, and in this *Poplar Bluff Printing Company* case the facts show that in every respect the structure not only resembles but was entirely identical with a corporate structure that was carried over from the dissolution of a corporation. In other words, after the corporation was dissolved the stockholders carried on with elections and under the same structure except for the actual incorporating

as they had before. There can be no question but this was actual resemblance to a corporation.

On Page 56 the Petitioner continues; in any event, he says the proposition is well established that for the purpose of determining whether an organization constitutes an association where parties operate under an instrument their relationship is governed by the powers conferred by the instrument rather than what the parties may have thought or even have done, and cities *Wholesalers Adjustment Company v. Commissioner*, 88 F. (2d) 156, 157 (CA 8) and also cites *United States v. Holmcrest Tracts, supra*, at Page 152.

The respondents have no objection to the statement of the law, it seems to be the holding of different cases cited, but, it isn't what could be done under the trust and not what is done, but in this case what could be *legally* done under the law under the partnership agreement. But, of course, petitioner has obscured and hidden that fact and that element in this case.

On Page 57 the petitioner cites a number of cases all along the same line, most of them, if not all, trusts whose functions were in a framework quite similar to a corporate structure and which cases hold as already stated that the tax consequences cannot be escaped by declining to exercise powers which the instrument of its creation permit. However, it isn't that Article X of the Limited Partnership Agreement contained powers which the partners declined to exercise, but rather that it contained powers which were unlawful for the partners to exercise.

It might be interesting to state at this point that as the court has no doubt observed there were *two* limited partnership agreements. The second limited partnership agreement created on June 30, 1943, was formed on substantially the same basis as the former one excepting that three additional children were brought into the partnership as limited partners, namely two daughters of George Johnson and a daughter of Albin Johnson. The capital of the general partners remained at $20,000 each (R. 673).

The point that there were two limited partnerships show what the partners themselves considered they could do in amending their organization under the laws of the State of Washington. It is obvious they came to the conclusion that no matter what the provisions were in the original agreement for the taking in of additional limited partners that when new limited partners were actually taken into the organization that an entirely new partnership was created and therefore the new articles of partnership or certificate of partnership, as it is called, under the law existing at the time, was created simply to take in these three new limited partners.

Petitioner cites the *Glensder Textile Co. v. Commissioner* case, *supra*, in pointing out that the tax court *minority* was, he argued, correct in stating that that case was decided in 1942 prior to the Supreme Court decision in *Commissioner v. Tower* and *Lusthaus v. Commissioner*, *supra*, and that at that time a Board of Tax Appeals "was not confronted by the juxtaposition of the family partnership rule with the sim-

ilarity of limited family partnerships to corporations and hence it cannot be regarded as controlling this question. It is for that reason, he argues, less persuasive than a more recent decision of this court holding certain family limited partnerships to be taxable as corporations," and he cites Giant Auto Parts, Ltd., 13 T. C. 307 and he goes on to say instantly by agreement the parties here obtained the advantages of corporate similarity which the Ohio State statute in the cited case of *Giant Auto Parts v. Commissioner*, 13 T. C. 307 afforded the family limited partnership association therein involved.

As respondent suggested before, this is the attempt of the Commissioner to make a new and second concept of the law of partnerships. The first strange concept having been ruled out by the Culbertson case, he now wants to make another new and strange concept taxing limited partnerships as corporations.

Respondent believes that it is safe to say that the *Giant Auto Parts Ltd.* case is one of the few, if not the only limited partnership case ever held to be an association taxable as a corporation. It is necessary before even reading the facts of the case to understand the Ohio State law covering the organization of limited partnerships, at least as they existed at the time the Giant Auto Parts, Ltd., limited partnership was formed. Sections 8059 to 8078 of the Ohio code provide substantially for the creation of a limited partnership and provides for election of managers and officers, the limited liabilities of partners, the transferability of interest, the manner in which the partnership may hold

title to property and bring suits, etc. There is also under the law itself insured continuity of the enterprise uninterrupted by any transfer of a member's interest whether by sale, debt or bankruptcy. 8066 and 8067, Ohio General Code.

Section 8063 of the Ohio General Code provides that the personal liability of members is limited to their respective subscription of capital. Under the provisions of this law itself it would appear that no limited partnership organized under this law could be anything other than an association so closely resembling a corporation as to defy the detection of difference. Except perhaps the office of the state in which the articles are filed and the amount of fees for filing the same. Under such a law, the *Giant Auto Parts, Ltd.*, case following it could hardly be held to be anything other than an association taxable as a corporation. There was an election of officers, the interests of the partners were transferred on several occasions, meetings were held to vote upon amendments to articles and motions were duly made, seconded and unanimously approved. It is not necessary to go further in the details of the case to show that this Ohio case was altogether different, both by enabling statute and fact, than the Western Construction Company partnership.

Continuing on Page 58 Petitioner cites *Helm and Smith Syndicate v. Commissioner*, 136 F.(2d) 440, and *Reynolds v. Hill*, 184 F.(2d) 294, which were both trust cases and involved an altogether different set of facts than are involved in the limited partnership at bar. But, using these cases by some weird analogy

Petitioner makes this conclusion, "thus, even though all three general partners should die prior to the expiration of its ten-year period, still reasonable continuity of the business is guaranteed for that period amounting to three lives and being for ten years and similar to the duration defined in business trust cases." This, of course, is absolutely untrue. Where the maker of this brief ever got such a conception of the law is beyond the respondents. Unless the probate laws be ignored and the partnership agreement be construed to create a trust of some kind. Under the laws of the State of Washington in existence at the time that the partnerships here in question were organized, *there could be no continuance of the business at all* upon the death of the three general partners except for the necessary time as provided for in the probate code, cited supra, for the winding up of the affairs.

Here is something else in connection with this theory of the Petitioners that should be brought to the attention of the court. Suppose that the theory of Petitioner that this partnership would continue although all three general partners should die prior to the expiration of its ten-year period were true, which, of course, is not the case. But, for the sake of argument, if it were true, each deceased's partners share under the probate law would become an asset of his estate and would have to be removed from the capital of the partnership. *How unlike a corporation is such a situation in a partnership under the laws of the State of Washington?* There can be just no analogy and certainly no similarity in this respect.

The Petitioner then under his Subsection 4 takes up the question of transferability of beneficial interest. And on Page 59 of his brief cites under Paragraph 12 of the Certificate of Limited Partnership (R. 668-669) the following.

> "The interest of all the limited partners herein may be transferred upon the approval of the general partners to accept a new assignee as a limited partner in this co-partnership and not otherwise."

And he further quotes Paragraph IX (R. 669):

> "The General Partners are hereby given the right to admit additional limited partners in the future upon the agreement of the general partners hereto but in no event other than a cash contribution to the partnership and upon the same terms as herein expressed."

And, again Petitioner cites Mr. Smith from 34 California Law Review, supra, on Page 533, where Mr. Smith observes:

> "Reasonable restrictions on the transfer of corporate stock are both lawful and common, but it seems that any absolute prohibition against all transfers of stock would be void as against public policy at least under normal conditions. This requires the conclusion that reasonable restrictions on the transfers of beneficial interests in an unincorporated enterprise are not very important; but it would not be unreasonable to hold that a spendthrift trust which contains an absolute and inescapable prohibition against transfers of beneficial interest is so unlike both the law and the practice

of corporations that it should not be classified as a corporation for the purposes of taxation."

Mr. Smith seems to be nebulous and inchoate in this conclusion. Take that phrase, "This requires the conclusion that reasonable restrictions on the transfers of beneficial interests in an unincorporated enterprise are not very important." Just how he arrives at this conclusion he does not explain and since by the Uniform Stock Transfer Act, in effect in Washington, R.R.S. 3803-101 through 125, there can be no restrictions on the transfer of shares of stock it seems that he and the law have departed one from the other. However, in all fairness to Mr. Smith it would appear from his reasoning and also from the Petitioner's theory that since holders of common and preferred stock in corporations may enter into agreements, such as voting trusts, proxies, etc., that they conclude that this makes a corporation similar to an unincorporated enterprise that restricts transfers of beneficial interest in the Articles or document that creates the enterprise itself. However, Mr. Smith later on in his article makes a much clearer analysis of the situation, but, of course, the Petitioner does not give us the benefit of this clearer thinking on the part of Mr. Smith. Let us cite Mr. Smith's final conclusions on the matter from his Law Review article on Page 534:

"A business corporation may or may not provide for selection of Directors by all the beneficial owners or for unlimited transferability of its stock or for limitation of the personal liability of officers, directors or stockholders. A corporation may or may not hold legal title to the property

used in its business. All these matters may be molded by charter provisions, by-laws and contracts into almost any form which the particular parties believe will best serve the needs of their particular enterprise, *but continuity, centralized management and something less than an absolute prohibition against all transfers of beneficial interest are fundamental traits of a corporation which cannot be eliminated by the parties without doing violence to well-established principles of corporation law.*" Emphasis ours.

We wonder why Petitioner did not give the court the benefit of Mr. Smith's final conclusions on this subject. Undoubtedly, it was because the Petitioner did not realize that Mr. Smith was speaking of a business corporation and not of a partnership and feared that the phrase "and something less than an absolute prohibition against all transfers of beneficial interest," which is the exact situation contained in Provision 12 of the Certificate of Limited Partnerships herein.

Respondents wish to point out that Mr. Smith undoubtedly was correct as far as he went and since he doesn't refer to partnerships at all, but only a business corporation, he is undoubtedly right.

Certainly the provisions above cited of the Limited Partnership articles in the case at bar are totally dissimilar, unlike and bear no resemblance to the stock structure of a corporation and are furthermore altogether unlike any of the trust cases cited by the Petitioner. The Petitioner on Page 61 then takes up his fifth subsection, the Limitation of Personal Liability. Of course, the limitation of liability of the limited

partners is set forth in the statute, supra. The liability of the general partners is unlimited. Realizing this, the Petitioner tries to sidestep it by saying, "However, it has frequently been held that complete limitation of liability is not an indispensible characteristic for corporate resemblance," and cites *Helm and Smith Syndicate v. Commissioner*, 136 F. (2d) 440.

All the court did in that case was to say:

> "Even if so limitation of the beneficiaries liability is not *sine qua non* of the corporate analogy."

But, in a partnership, respondents urge, there is quite a different situation, because as provided for in the laws of the State of Washington, the title to any property, the ownership of the property can only be held by and through the general partners whose liability was unlimited. They were the only ones that could sue or be sued.

Here is another interesting feature in regard to the limitation of personal liability. In the partnership act as it existed at the time these limited partnerships were organized a limited partner might also become liable as a general partner. (We print it below again as a Footnote, although it has been cited before.)

R.R.S. 9971

9971. Name of firm—When special liable as general partner. The business of the partnership may be conducted under a name in which the names of the general partners only shall be inserted, without the addition of the word "company" or any other general term. If the name of any special partner is used in such firm with his consent or privately, he shall be deemed and treated as a general partner, or if he personally makes any contract, respecting the concerns of the partnership, with any person except the general partners, he shall be deemed and treated as a general partner in relation to such contract, unless he makes it appear that in making such contract he acted and was recognized as a special partner only.

Re-reading this provision of the law, the court will immediately see that in the event a special partner oversteps certain bounds he becomes a general partner and his limitation is removed. If he allows his name to be used in the firm, he shall be deemed to be treated as a general partner or if he personally makes any contract respecting the concerns of the partnership with any person except the general partners, he shall be deemed and treated as a general partner in relation to such contract, unless he makes it appear that in making such contracts he acted and was recognized as a special partner only. So that, in the instant case, we have a peculiar provision riding upon the head of every limited or special partner. Certainly, a contingent liability that is not in any way analogous to any provision of corporate law as it effects the right of a stockholder.

Petitioner on Page 61 of his brief repeats a pat little situation which he first uttered on Page 32:

> "In fact if the general partners were thought of as common stockholders and the special partners as holders of participating preferred stock, the entire arrangement would be identical in all respects with a corporate structure except for the unlimited liability of the general partners."

This is error exaggerated beyond belief. Ignoring for the purpose of the argument the finding of the tax court that this partnership was a bona fide partnership, let us see what other finding the tax court made that bear upon this present argument:

> "There was no delegation of authority by the limited partners to the general partners. The lim-

ited partners held no meetings regarding such delegation of authority, elected no officers and representatives and received no certificate or other evidence of their contribution as limited partners other than the partnership articles. (R. 681.)"

"The limited partnership was not operated with any of the usual formalities of a corporation or association. There were no officers, no regular or formal meetings, no by-laws, no board of directors, seal or minute books. The Western Construction Company held itself out to the public as a true Limited Partnership. The parties to the Limited agreement here involved formed a bona fide partnership and truly intended to join together for the purpose of carrying on the business of the partnership. It was not an association taxable as a corporation. Proper statutory notices of formation of both Limited Partnerships was given. The Limited Partnership agreements provided that the general partners could admit additional limited partners and continue the business on the death or retirement of a general or limited partner. Those rights could be exercised only by agreement among the general partners. (R. 681-682.)"

These findings would seem to be conclusive, certainly no error has been pointed out in them by Petitioner except his theories as to the ultimate conclusions. However, for the purpose of argument let Respondents point out in detail that the Limited Partnership does not bear the slightest resemblance to a corporation:

1. The partnership owned no property. Property under the law was owned by the partners as shown by the tax returns the partnership made, the partnership made the necessary tax returns

but the taxes were paid by the general and limited partners. The partnership set forth, supra, could not bring suit in its own name or be sued in its own name.

2. There was no centralized representative management or management of one or more persons acting in a representative capacity. Here we have only partners acting in the traditional and historical sense as partners, each one liable for the whole partnership debts (that is the general partners), and certainly they were not as has been pointed out in different cases, supra, elected, chosen or acted in any representative capacity other than that of true partners and for this court to hold that there was a centralized management by three general partners who, under the law, of the limited partnership could be sued and were joint and severally liable would be to form a new and strange concept of the law of partnerships for tax purposes, the very thing that Justice Frankfurter and Chief Judge McGruder warned against.

In the *Glensder Textile Co. v. Commissioner* case, 46 B.T.A. 176, supra, the Tax Court analyzed this situation and said:

> "There was centralized control by the general partners but this fact did not make them analogous to directors of a corporation. They were acting in their own interest as hitherto, which constituted five-twelfths of the partnership and not merely in a representative capacity for a body of persons having a limited investment and a limited liability."

This, of course, isn't a trust company case and both

Smith and Petitioner are confusing those cases with partnerships. The Limited Partners here had no right whatever to vote upon the managers, to remove them or to do any of the things that a stockholder is privileged to do under the corporation laws of the State of Washington. None of the limited partners could, of course, have the privilege of cumulative voting or even call a meeting of the limited partners alone or of the general partners. They had no representative rights at all. Uniform Business Corporation Act, R. R. S. 3803-1 through 3803-50.

In the case of *Hecht v. Malley*, 265 U. S. 144, cited by Petitioner, which was a Massachusetts trust case, it was said on Page 159:

> "It would be a wide departure from normal usage to call the beneficiaries here a joint stock association when they admitted not to be partners in any sense. * * *"

This is one of the tests that Petitioner continually overlooks and that Mr. Smith does not deal with in his article and that is that as we have stated heretofore many times, that where you have a real partnership you have a situation altogether different because *of the meeting of the minds of the partners*, the agreement between them. The joint venture in itself, the historical value of the relationship and the new modified limited partnership uniform code which is becoming so popular with the different state legislatures, already adopted by 32, supra. That this entity when it exists although it may have the faint similarity to a corporation in that it is engaged in business, nevertheless is an entity

of its own and must not be confused with these loose trust arrangements, pools and other associations which the Commissioner tried to reach in his regulations, supra.

If the test that Petitioner seeks were to be adopted by the court, that is to say that the general partners with their unlimited liability were to be designated as representatives of the joint enterprise simply because they are the general partners, then, of course, every limited partnership in all of the 32 states and states that have similar partnership law would be in a trap of tax consequences with the exception of the State of Ohio, whose code is so different.

Such a decision would subject all of the limited partnerships formed under the laws of these different states to taxation as a corporation. *There can be no question about this consequence.*

> 3. The third point, the continuity of the partnership, has been gone into so thoroughly before in this brief that Respondents simply wish to repeat that there was no continuity of the partnership as a whole possible, but for a limited time after the death of one of the general partners or even of a limited partner, under the probate laws of the State of Washington then in existence. It will be noticed that there is no distinction in the probate laws of the State of Washington between a limited partner and a general partner. However, under the Uniform Limited Partnership Act, R. R. S. 9975-80, enacted two years after the last Limited Partnership herein was formed, there was a change in the act which permitted limited partner-

ships to continue after the death of a partner if there are special provisions covering the same in the articles of copartnership. This was not the case, however, in the law at the time of these instant partnerships.

The *Glensder* case, *supra*, had a much weaker structure as far as this feature was concerned and also other features, but the Tax Court held that the *Glensder* case was not an association taxable as a corporation.

4. Point Number 4, the transferability of beneficial interest is rather simple. Suffice it to say, there were no certificates of interest whatever, the only right the limited partner had was that expressed in the certificate and that, of course, under Section 12 of the certificate, his interest could be transferred only upon the approval of the general partners to accept a new assignee as a limited partner in this copartnership and not otherwise. This provision certainly fits the test cited by Mr. Smith, whom, it will be remembered, stated succinctly:

"* * * And something less than an absolute prohibition against all transfers of the beneficial interests are fundamental functional traits of a corporation which cannot be eliminated by the parties without doing violence to well established principles of corporation law."

5. Limitation of Personal Liability. Unless the courts are going to throw out the principle of limited liability as contained in all of the Uniform Limited Partnership laws and all similar limited partnership codes, then the limitation of the special partners is not to be controlling. The control-

> ling feature would be whether or not the managers or the general partners had a limitation of liability and here, we believe, is one of the tests that has been truly applied in most of the cases. There may be one or two exceptions where all of the other attributes of a corporation were present, but in at least all but one or two of the cases cited in Petitioner's brief and in nearly all the trust company cases is the *significant fact* that the trustees or managers of the enterprise had limited liability. Here, as in the historical partnership, general partners have no limitation whatever on their liability as a general partner and this must be one of the controlling features, that difference between a partnership and a corporation that cannot be ignored or easily explained away.

Respondent submits that if a jig could be made, as is done in a factory, and one jig could be labeled corporation and made in the corporate form containing the different essential elements of a corporation, and another jig could be made to form the outline and contain all the elements of a limited partnership, that the two jigs would have irreconcilable differences in their pattern and the two could not fit together one over the other or one within the other.

Again, we have an element not mentioned by Petitioner or Mr. Smith or in fact, considered in many of these cases which, of course, were trust cases, where this particular element would not be contained and that is, as we have repeated again and again, and that is the warm contact between two or more individuals in a joint adventure. We have that in a high degree in the Western Construction Company. Respondents submit

in a higher degree than in most of the so-called family partnerships which have been decided in favor of the taxpayers over the last few months. We have the sincerity of purpose, the desire to form a partnership and that alone, that true partnership principle, makes a jut or a jog in the jig of the limited partnership which throws it all out of line with the corporate pattern.

Also, the limited liability feature of the corporate structure throws it entirely out of line with the general liability of the general partners. The corporate structure must own or hold title to its property. It sues or is sued in its corporate name. Even a lease could not be made in the name of the limited partnership under the laws of the State of Washington then in force. The lease would have to be drawn in the name of the general partners. There was no representative committee or trustee, or manager, as is the fact in most of the cited cases in appellant's brief. We have only the historical general partner. The limited partners had no easy way of selling their interest or transferring it, in fact, it could only be done upon the agreement of the three general partners. See Tax Court Findings, supra. Respondents submit that not only the Tax Court, the trier of the facts, made a finding that the partnership here was not an association taxable as a corporation, but has supported that finding by the other findings set forth above, each one conclusive of the fact that under the principles set forth in the Morrissey case, supra, that these partnerships could not be construed to be an association taxable as a corporation, but that the law itself must conclude, if it is a question of law,

that there was no association here taxable as a corporation.

Petitioner isn't satisfied to rest with his Morrissey case test, but now has to go on into the stratosphere to work out the last perspiration in his theoretical pores regarding the mythical corporate likeness of Western Construction Company. He cites *State ex rel. Range v. Hinkle*, 126 Wash. 581, 219 Pac. 41, wherein the Supreme Court of Washington quoting the state Constitution expressed the following on Page 583:

> "Under constitutional provisions similar to Section V, Article XII, supra, it is almost uniformly held that joint stock companies and limited partnerships organized under statutory authority are in fact corporations."

This case decided so long ago has caused the Supreme Court of the State of Washington some trouble ever since on account of this ill-considered statement, but finally the court in the case of *Haynes v. Central Business Property Company*, reported in 140 Wash. 596, on Page 599, made the following ruling:

> (1) The appellant's first position is that the association of unit holders as created by the trust deeds is a common law trust and illegal. There are two reasons why this position cannot be sustained, the first of which is that, if a common law trust exists and is assuming to exercise the powers and functions of a corporation, *the state is the only one that can complain. Frost v. Puget Sound Realty Associates*, 57 Wash. 629, 107 Pac. 1029. In the case of *State ex rel, Range v. Hinkle*, 126 Wash. 581, 219 Pac. 41, the state resisted the application

> of the realtor for a certificate entitling it to do business as a common law trust, and in *State ex rel. Colvin v. Paine*, 137 Wash. 566, 243 Pac. 2, 247 Pac. 476, the action was brought on behalf of the state."

This would seem to answer completely the theory of the Petitioner in this respect.

Respondent's note that on Page 63 and 64 that Petitioner ends up his dissertation regarding the theory that the partnerships in this matter are associations taxable as corporations with a complete dive into nomenclature.

Respondent don't believe that this court is interested in form more than substance, but the fact that the Petitioner has to make a dive into words signals the weakness of his theory. Petitioner refers to the Washington Statute and to the phrases "common stock" and "capital stock." Petitioner also refers to Remington's Revised Statutes, Sections 9972 and 9968 which provide:

> "No part of the capital stock thereof shall be withdrawn," etc.

and also:

> "The amount of capital which each partner has contributed to the common stock."

These same phrases and the same provision is contained in the Uniform Limited Partnership Act, but in the statutes in force in the State of Washington applicable to the partnership herein these provisions simply meant the total interest of the partners and each partnership share or beneficial interest in the partnership as a

whole. They could mean nothing else. There was no stock and no certificates of stock.

To refresh the court's memory again, R.R.S. 9973 provides:

> "All actions, suits, or proceedings respecting the business of such partnership shall be prosecuted by and against the general partners only, except in those cases where special partners or partnerships are to be deemed general partners or partnerships. * * *

Taking the laws of Limited Partnerships of the State of Washington as a whole at the time these partnerships were created, there certainly cannot be any construction that there was capital stock similar to that of a corporation whatsoever. The use of these phrases and words by appellant is but a forlorn adventure in nomenclature.

CONCLUSION

Since Respondent has already in the first section of his brief gone into the questions of the actual partnership of which the limited partners were component members, the Petitioner's argument beginning on Page 64 shall be answered briefly.

It is significant that since the *Commissioner v. Culbertson case, supra,* and, indeed, the decision in the case appealed from herein, that there has been a number of family partnership cases cited by the tax court and several of them appealed from the Tax Court and decided by the different Circuit Courts of Appeals.

Petitioner has cited only four cases since the Culbert-

son case, and one of these cases was a District Court case, *Toor v. Westover*, 94 F. Supp. 860 (S. D. California).

In the concluding pages of this brief Respondents will list a great many of the cases which have been decided by the Tax Court in favor of the taxpayers where the facts, respondent believes, are much weaker than the facts in the case at bar, and Respondent has already cited in this brief the following cases decided by different Courts of Appeals after the *Culbertson* case: *Lamb v. Smith*, 183 F. (2d) 938; *Cobb v. Commissioner*, 185 F. (2d) 255; *Ginsburg et ux v. Arnold et al*, 185 F. (2d) 913, and will cite two others later.

The *Ginsburg* case, the court will recall, is the case where the father gave interests in the partnership to a son and two daughters, paying a gift tax on the transaction.

Let us now examine the four cases cited by Petitioner. However, we should have mentioned that in addition to the four cases since the *Culbertson* case was decided, on Page 65 the Petitioner goes back to the *Tower* case and quotes a part of the Supreme Court's ruling on that case. However, it will be remembered by this court that the facts in the *Tower* case were altogether different from the facts in the case at bar. The *Tower* case was one of those husband and wife partnership attempts where there was no change at all in the situation of the husband and wife before and after the purported partnership agreement was made. The husband controlled all of the business and all of the income as he had before. There was no change in

the bookkeeping, the wife drew no dividends and the only drawing she made was the same as she had before for living expenses, etc. It is obvious that no court in the examiation of the facts in the *Tower* and *Lusthaus* cases would hold that these cases were true partnerships.

In the *Crosley v. Campbell case, supra*, the court said on Page 642:

> "This court stated in *Greenberger v. Commissioner*, 177 F. (2d) 990 on Page 994, C.C.A. 7, "The court in the Culbertson case left no doubt that the predominant factor is the good faith and the legitimate purpose of the parties in forming a partnership. * * *"

That seems to succinctly sum up the *Culbertson* case ruling and respondent submits that in this case the intent, good faith and purpose of both the general partners and the limited partners cannot be other than found to be in support of the Court's findings that it was a valid and bona fide partnership.

The Tax Court heard the witnesses on the stand, had a chance to observe their demeanor and test their credibility.

The only thing Petitioner does is to make conclusions of his own, such as, "the record is replete with indicia that the parties did not intend to join together with a business purpose in the conduct of a partnership," but Petitioner does now show the court the facts that support such a conclusion. Indeed, the facts that Petitioner does set out conclusively support the findings of

the Tax Court. Let us examine them. On page 67 in the second paragraph, the Petitioner says:

> "And while the sons contributed engineering skill which the general partners lacked of substantial value to the partnership, such services as they did perform were in part at odd hours and in addition to regular employment elsewhere were under the direction of the general partners."

Now, what is wrong with that? In several of the cases above cited, the family partners contributed no services or influence. Here we have engineers contributing valuable services, and while those services were rendered after hours that does not make them less valuable, or does it make their intention less true and honorable. In fact, does it not strengthen the intention and good faith of the parties rather than weaken it?

Petitioner says that the Tax Court found that the daughters did not render any services to the limited partnership of any substantial consequence. Well, they signed notes, promissory notes, that were absolutely good and collectible. It will be remembered that no daughter or son was taken into the limited partnership until they had reached their majority and would be legally liable on the note. If, a general partner had died at any time before the notes were paid, Petitioner would have to admit that the administrator or executor of the general partner's estate certainly would attempt to collect that note and that the daughter would have to pay it, whether or not she had any assets of the Limited Partnership to draw from or not. It will be re-

called that there was no provision, as there is in some of the cases, that the notes were to only be paid out of partnership profits. They were to be paid without any restriction of any kind. It was simply a straight promissory note without any change in usual business form.

And, the court found that the general partners used these notes for the purpose of securing credit and the fact is found that they did get an additional loan of $50,000 after the notes were accepted by the Fathers, the general partners. But this partnership goes much further. As the trial court set forth these older men wanted to have their sons in with them. They made an attempt once before to get their sons to join them in the partnership. On January 6, 1941, Articles of Copartnership naming six individuals as partners were prepared and executed. This partnership, however, was never actively operated and no books or accounts were ever set up for it. (R. 663-664.)

After that the first limited partnership agreement was made and the court found:

> "* * * But rather the result of many years of thought by the general partners who were anxious to have their sons, daughters, and sons-in-law come into the business so that it would continue after the general partners retired or died." (R. 676.)

For the benefit of Petitioner who used this finding to suggest continuity of the enterprise, may we remind the Petitioner that it was just that, the continuity of the *enterprise as the court said* "come into the *busi-*

ness so that it would continue" not the *partnership.* There is a legal distinction.

Petitioner doesn't seem to like the dream that Winston Johnson testified to. He set it forth in his brief on Page 51 and we urge the court again to read it. Here is evidence of good faith. Certainly the Judge who heard this young man testify on the stand probed his very heart and knew that he was telling the truth, or that Judge would not have held for respondents, as he did.

There can be no question, it seems to us, from this record that the only reasonable inference and conclusion that could be gained from these facts is that the decision of the Tax Court is without error in all respects.

On Page 66 the Petitioner cites the case of *Maytag v. Commissioner,* decided March 21, 1951, (C.C.H. Federal Estate and Gift Reported, Paragraph 10,800). In this case the Court of Appeals for the Tenth Circuit said, referring to the Tax Court:

> "Finding must be treated as clearly erroneous if based upon substantial error in the proceeding, if unsupported by any substantial evidence, if contrary to the clear weight of all the evidence or if supported by evidence, but the court of Appeals in reviewing the entire evidence entertains the definite and firm conviction that a mistake has been committed."

Certainly, respondent can't find much objection to the statement of the law; certainly a finding would have to be erroneous if based upon substantial error

in the proceeding and if unsupported by any substantial evidence, particularly if contrary to the clear weight of all the evidence.

On Page 69 and 70 of his brief, Petitioner is evidently thinking that this court might be influenced by the amount of profit that was estimated to be made upon the 40 per cent completion of the contract as referred to before, so he sets out the figures again and then draws the unreasonable, impractical, unique and novel conclusion:

> "In view of the foregoing it seems clear error for the Tax Court to have found that the $60,000 credit which the children contributed in this unusual and circuitous manner was of any substantial importance to the financial status of the business or of the general partners."

The trial court has found and certainly this Court has practical knowledge of such things, that with the assistance of the notes another $50,000 in a loan from a bank was obtained. Let me suggest to Petitioner that without this additional $50,000 to the already owing $80,000, it was quite possible that the jobs would not have been completed and there would have been no profits made but rather a tremendous loss sustained. That there is no comparison in the amount between the new credit obtained and the profits that were finally made. This isn't a matter of interest upon money. As we have said before the trial court found:

> "The construction company represents a hazardous financial risk and it is possible to lose heavily as well as to realize large profits."

And, Petitioner's statement that the capital which the children contributed "in this unusual and circuitous manner" is remarkable in that it was a pure business transaction with regular promissory notes instead of the gifts which so many of these other cases have as a part of the facts in the case. Nevertheless, the courts have accepted the gift from the fathers to the children as an element of a true partnership. The *Ginsburg* case, *supra*, is one of them. So respondents inquire, what is this unusual and circuitous manner?

Then Petitioner uses the phrase in the next paragraph:

> "Pending profits on the partially completed Government contract."

Respondents submit that there is no such a thing as *pending profits* on *partially* completed government contracts. There is only a sure profit on the completed government contract.

It might be well at this point to remind the court that, as the trial court found:

> "They endeavored to persuade other companies to join them on bids but the West Park Project at Bremerton indicated that this was not a satisfactory solution. They also tried unsuccessfully to get outsiders to invest in the partnership. Thus faced with the desire to include their children in the business and with the need of additional financial backing the brothers decided to form a Limited Partnership in which the brothers would be the general partners and their adult children the limited partners." (R. 664)

It might be well to support the finding of the court with the testimony of George Johnson.[4] (We are putting this as a footnote taken from his testimony (R. 290, 291, 292).

Respondents might mention that not only was this the testimony of one of the general partners, but that Frank Oscar Granston was put upon the stand as a

[4]Q. Now, will you tell the court the reasons you had for the formation of the limited partnership?

A. Well, we were constantly looking forward to being able to take the larger work. But before it was well to take a plan and start and figure, you had to contact people to see if they would furnish a bond in that amount, and most of the time we heard, "No." So we were not able to reach the goal or even start to figure on it. So we called in Philip Johnson of the Boeing Company, because we knew him pretty well. We had built his home and after considering it a little bit why he said, "No," he was going to use his money elsewhere, and we found out that he was not interested.

Q. I am not quite sure that I understand you. You called in Philip Johnson, you say?

A. Yes, sir.

Q. For what purpose?

A. And asked him if he would be willing to put in $25,000 or $50,000 with us—if he would not invest some money with us.

Q. Are you referring now to the partnership?

A. Into the partnership—yes.

Q. All right.

A. But he answered us declining that request.

Q. Do you know where Mr. Johnson is now—Philip Johnson?

A. Mr. Johnson passed away a few years ago.

Q. Go ahead.

A. We then asked Clyde Phillips who was also at that time one of the bonds salesmen here in Seattle, if he would take some of his private money and put it in with us, because he was furnishing bonds for us. But he could not furnish the bonds for the jobs that we wished to figure on. Well, he, of course, would have put in money with us, but, of course, he would have wanted such a huge part of the partnership, so that we would have been working for him rather than for the Western Construction Company. So then we saw Granston of the University Plumbing Company.

Q. The gentleman that just preceded you on the stand?

A. Who just testified, yes, sir. We have known him very well for many years. But, of course, he has a business of his own and, of course, naturally, he wants to have enough money so that he can paddle his own canoe. and he might also have thought, "Well, it is not so sure to invest the money in general contracting because it is—you don't make money on every job you take. It is a risk."

Q. Well, did you succeed in getting any capital in?

A. No, we did not.

witness, one of the men whom the general partners approached with a view of getting money from him. (R. 285, 286.)

If, instead of having inadequate finances to take these big jobs, the general partners had had substantial financial reserves to go into these contracts the Petitioner might find some substance to his arguments about the profits, but the fact, of course, was altogether different. But, even so, suppose that the general partners had substantial financial reserves at the time the limited partnerships were organized. Would that fact change the good faith and intent that was manifest in this record in the organization of the limited partnership and cause this court to reverse the tax court on its finding that this was a bona fide and real partnership? Respondents submit that it would not and that with the further financial need of the general partners that this record is clear that there was not, as Petitioner intimates, a melon of some sort to be cut and all profits were made and everything was done that should be done but that a subterfuge had to be entered into in order to reduce taxes.

The trial court went into that matter quite thoroughly and made this finding:

> "This decision was made without discussion with tax counsel, accountants, or attorneys as to whether it would be cheaper to do business as a partnership rather than as a corporation." (R. 664.)

Petitioner in this third paragraph on Page 70 says that some of the limited partners withdrew their share

of the profits but the majority actually did not withdraw a great deal of their profits as the tax court found. On Page 22 and 23 of Petitioner's brief he has set out a number of substantial amounts withdrawn by the partners. One partner withdrew $6,000 more than he had to his credit. Other partners withdrew amounts such as $36,000, $49,000, etc. It is true, of course, that the limited partners paid their income tax and paid them out of profits. What possible point can Petitioner make of that?

Finally Petitioner cites *Stanback v. Robertson*, 183 F.(2d) 889, C.C.A. 4, and Respondents believe makes a very misleading statement. Petitioner says:

> "For similar reasons limited partnerships were not recognized for tax purposes."

The *Stanback* case was a collateral estoppel case. The court on Page 894 said:

> "* * * Here the precise issue before us has not been previously adjudicated and even if it had been, the law applicable to the situation had been altered by supervening decisions of the Supreme Court."

By supervening decisions of the Supreme Court the court referred to the *Culbertson* case, *supra*, so that it is clear that this case has no bearing upon the instant matter at all, and we might add that in that case a jury in the district court had held against the partnership.

The next case immediately following the statement "for similar reasons limited partnerships were not

recognized for tax purposes" is the district court case of *Toor v. Westover*, 94 F. Supp. 860, Southern District of California, Central Division, Judge Yankwich, District Judge. It is only necessary to cite from Judge Yankwich's opinion to clearly distinguish the *Toor* case from the case at bar. The judge says on Page 863:

> "Granting that a limited partnership may be created, California Corporation Code Section 15507-15518, so as to benefit from the provision of Section 181 of the Internal Revenue Code, I am of the opinion that * * * including the amount allocated as profits each year was so exclusively under the domination of the plaintiff that to all intents and purposes the creation of the partnership made no change whatsoever in the manner in which the business had been conducted before."

Petitioner's concluding case, *Lamb v. Smith*, 183 F.(2d) 938, decided April 17, 1950, in which a jury verdict sustaining a limited partnership was under scrutiny, does not give any comfort to the Petitioner and the Petitioner's statement:

> "And hence the scope of review was more limited than here where the fact finding may be set aside for clearer error."

does not give the court or respondent any idea of what Petitioner is driving at. An examination of the case shows that the jury, of course, was sustained in its finding and the court said on Page 942:

> "The rule stated applies in tax cases where the government challenges the existence of a partnership for tax purposes. In determining whether there was a true partnership for 'income tax pur-

> poses,' the fact that there was no contribution of 'original capital' or 'vital services' is to be taken into consideration, but it is not conclusive."

And on Page 642, the court says:

> "The finding of fact that there is (or is not) a partnership by the trier of the facts (tax court or jury) if supported by the evidence is final. *Davies v. Commissioner*, C.C.A.(3d) 161 F.(2d) 361."

However, Petitioner should not mislead the court. The *Lamb v. Smith* case was not reversed on the verdict of the jury for reason of any partnership question. The case was remanded and sent back to the trial court *because the wife had filed a joint return with the husband.*

Since dictating this brief, the respondents have located several recent cases in late Prentice-Hall Tax Service Bulletins.

The case of *Edward A. Ardolina v. Commissioner of Internal Revenue*, decided in the United States Court of Appeals, Third Circuit, No. 10,197, decided January 2, 1951, 72,212 P-H, Fed. 1950.

> "The Tax Court's ultimate finding of fact that petitioner and his wife did not actually intend to join together as partners in the conduct of the enterprise is clearly wrong.
>
> "The decision of the tax court will be reversed."

Acting Collector of Internal Revenue v. Harry B. Green and Augusta M. Green, U. S. Circuit Court of Appeals, Fifth Circuit, No. 13,144, January 10, 1951, 72,227, P-H Fed. 1951. The facts briefly are that the

minor daughters put in capital *by promissory notes*, where were paid off with *business income*. The Collector of Internal Revenue appealed from the District Court finding that the partner taxpayer and his daughter had intended in good faith to form and had in fact formed a valid partnership. The collector insisted that the findings were wholly erroneous; the court said:

> "* * * We cannot agree. The partnership, though made with minors, was valid under tax law. So valid, it was valid, against the claim of the commissioner, unless it was entered into not in good faith but as a sham or pretense. The district judge, upon evidence sufficient to support his findings, has found good faith in law and in fact. We cannot, on this record, set these findings aside as clearly erroneous.
>
> "The judgment is affirmed."

Counsel for Petitioner certainly must shudder at the very thought that here *minor daughters* gave notes and were held to be true partners. How much stronger is the case at bar where adult responsible daughters and sons gave notes which were used to obtain monies for the good of the partnership.

The following United States District Court cases are recently reported showing family partnerships recognized for tax purposes either by jury or by District Court judge:

Archibald Sparks Brown, Sr., v. William E. Davis, U. S. District Court, Southern Division, Northern District of Alabama, 6470, November 13, 1950, 72,398

P-H Fed. 1951. Wife, daughter and son gave notes and neither child nor wife rendered vital services.

J. A. Morrison, Jr., v. John L. Fahs, individually and as United States Collector of Internal Revenue for the District of Florida, U. S. District Court, Southern District of Florida, Miami Division, No. 1271-M, April 2, 1951, 72,394 P-H Fed. 1951. Taxpayer's mother was recognized as a real partner in the family firm that succeeded father and son partnership. The mother supervised preparation of food, a vital phase of the business.

Lee A. Long v. United States, U. S. District Court, Western District of Oklahoma, No. 4760-Civil, 72,286 P-H, settled 1951. Wife recognized as partner in business that was a valid partnership under state law.

Respondent expected to cite a number of cases decided in the tax court recognizing family partnerships for tax purposes, but found there were so many of them that it would be inconvenient to put them in this brief.

In final summation, respondents conclude as follows: The Commissioner by his Notice of Deficiency took admittedly inconsistent position that: (1) Western Construction Company, the limited partnership, is an association taxable as a corporation, and (2) the partnership entity should be disregarded for tax purposes and all the income attributed to the three general partners.

It would certainly seem that the Commissioner, in taking these inconsistent positions, has succeeded in casting doubts on the presumptive correctiveness of

both. Certainly, he could not be right on both and the Tax Court found that he was right in neither of these inconsistent positions. The Tax Court made the following ultimate findings:

1. The parties to the Limited Partnership agreements here involved formed a bona fide partnership and truly intended to join together for the purpose of carrying on the business as a partnership. (R. 681.)

2. It was not an association taxable as a corporation. (R. 681.)

The findings of the Tax Court supporting the ultimate findings 1 and 2 given above, are as follows:

1. *Bona fide partnership*

(a) The monies which these adult children borrowed from their fathers and used to invest in the limited partnership were bona fide loans. The general partners had minor children but they were not taken into the partnership because they wanted notes from adults fully responsible for payment. The notes were negotiable, bore interest, and were all for short terms not exceeding two years, except the first two notes of Lloyd Johnson and his sister, Bernice Wallin, to their father, George Johnson, for $10,000 each. These notes were installment notes payable in yearly installments of not less than $3,500 in any one payment. (R. 675.)

(b) These notes were never placed as collateral for any loan but they were listed as personal assets of the general partners in application for construction bonds. On July 30, 1942, an addi-

tional $50,000 was borrowed from the bank. (R. 671.)

(c) Each of the children knew and understood he was signing a note which was unconditionally payable and which represented a bona fide obligation on his part. They did not take on these obligations lightly as there was considerable discussion about the notes before signing them. * * * Rachel Gustafson, the daughter of George Johnson, was invited to participate in the first limited partnership. However, she declined to do so as both she and her husband did not desire to sign a note for $5,000. They knew that the construction business was subject to heavy losses, as well as handsome profits. (R. 671.)

(d) Division of such profits was made with the limited partners on the basis of their stated partnership interests. (R. 676.)

(e) The limited partnership was not the result of an impulse set off by the desire to minimize taxes, but rather the result of many years of thought by the general partners who were anxious to have their sons, daughters and sons-in-law come into the business so that it would continue after the general partners retired or died. (R. 676.)

(f) Lloyd did not work as an employee of the limited partnership but he did perform important services for the firm. He was a graduate engineer with a great deal of experience. * * * He did a great deal of night work, helping the general partners on matters relating to engineering, bids and estimates. He did not receive any compensation for this work but he devoted a considerable amount of his time because of his interest as a

limited partner. It was of great value to the partnership. (R. 677.)

(g) Roy Johnson rendered no regular service to the limited partnership until January, 1943, when he devoted full time to its affairs. During this period he worked as an engineer designing layout foundations, excavating footings, roads, buildings, arches and superintending both large and small jobs. (R. 677-678.)

(h) Winston Johnson worked for the partnership at all times after March, 1942, when he was released from the Army. He had had three years of college training as a civil engineer and did various types of work for the firm. (R. 678.)

(i) The partnership profits were regarded by all of the limited partners and their spouses as community property. * * * Partnership checks representing distribution of profits were sometimes made out to the limited partners and sometimes to the spouses of the limited partners, depending upon which one requested the money. (R. 678-679.)

(j) The limited partners were entitled to withdraw their share of the profits as they pleased and the share of the profits credited to the individual partners' accounts were in no wise considered to be anything but their own property. No limited partner ever withdrew any profits and turned them over in any way to the father, the general partner. No limited partner was in any way dependent upon his or her father, the general partner, for support, either at the time of the formation of the partnership or later. (R. 679.)

(k) The freedom of withdrawals by the limited partners without consulting the general partners is illustrated by the various uses they made of their profits. (R. 680.) Illustrations continue on R. 680.

2. *Limited Partnerships were not taxable as corporations*

(a) The three general partners managed the limited partnership in the same manner that they had the business which preceded the limited partnership. As general partners, the management and direction of the business was in their hands and all their personal assets, including the notes of the limited partners, were subject to possible loss in the event the limited partnership failed. (R. 680-681.)

(b) There was no delegation of authority by the limited partners to the general partners (R. 681.)

(c) The limited partners held no meetings regarding such delegation or authority, elected no officers and representatives and received no certificates or other evidence of their contribution as limited partners, other than the partnership articles. (R. 681.)

(d) The limited partnerships were not operated with any of the usual formalities of a corporation or association, there were no officers, no regular or formal meetings, no by-laws, no board of directors, seal or minute book. (R. 681.)

(e) The Western Construction Company held itself out to the public as a true limited partnership. (R. 681.)

(f) Proper statutory notice of the formation of both limited partnerships was given. (R. 681.)

(g) The limited partnership agreements provided that the general partners could admit additional limited partners and continue the business upon the death or retirement of a general or limited partner. Those rights could be exercised *only by agreement* among the general partners. (R. 681-682.)

Under "clearly erroneous" rule Tax Court's findings should stand as to both Ultimate Findings (1) and (2) above set forth.

As to Ultimate Finding (1) not only because specific findings of trial court are unchallenged by Petitioner except for specious arguments as to effect of facts, but because the specific facts are so strong in support of the ultimate finding that had the Tax Court found the reverse, this court, as in the late case of *Edward A. Ardonila v. Commissioner of Internal Revenue, supra,* would have in all conscience been compelled to reverse the trial court on the ground that the ultimate finding was "clearly erroneous."

The specific findings in the case at bar are much stronger, respondents sincerely believe, than any of the cited cases, where the partnerships have been held to be bona fide.

As to Ultimate Finding (2) we have in the instant case a different situation than has appeared in any of the cited cases for the reason that here we have inconsistent tax deficiencies sought for by Petitioner. If Ultimate Finding (1) is affirmed as respondent believes it must be, *then a real partnership for tax pur-*

poses or any other purpose, as Justice Frankfurter finds these situations identical when challenged by the government. Obviously, a true partnership cannot be an association taxable as a corporation.

But, for sake of argument and answering Petitioner's brief, respondents contend that the Ultimate Finding (2) of Tax Court is not erroneous and therefore must stand.

And that in any event both facts and law uphold decision of Tax Court for the reason the tests set out in the *Morrissey* and companion cases, *supra*, applied to the partnerships here in question, show no resemblance whatever to corporations in the sense used in said cases.

1. *Title in a single entry.* Title and any ownership of property under Washington State Law in force at time of partnership organization vested in general partners. No title or ownership in entity. All suits had to be brought by or against general partners. Name has to include General Partners.

2. *Centralized Management.* As Tax Court found (finding (a) under Ultimate Finding (2) *supra*) the three general partners managed business in the same manner as they had before they took in limited partners. Certainly special partners had no choice in their selection or power of removal. Nothing resembling voting power of stockholders. No representative management as defined in "Words and Phrases," *supra.* General partners owned together approximately 50 per cent of partnership assets. Pure historical and

legal partnership management. General partners can act *jointly or singly.*

3. *Continuity of Enterprise.* Under laws of State of Washington in existence at time, even though Articles of Co-partnership provided that general partners could continue business upon death or retirement of a partner, partnership after the time provided by statute, *supra,* must be dissolved and would be by Washington law. Also, if valid, requires agreement of general partners. Question if Court of Equity would enforce provision.

NOTE: *Glensder Textile Company* case, *supra,* under Uniform Limited Partnership Act in State of New York has such a provision for continuance as new Limited Partnership Act in Washington (Uniform Act) does.

In any event, there was no legal and valid provision for continuity and even if the Uniform Code had been in effect no such continuity as provided for in a corporation existed.

Also, deceased partners' interest would be withdrawn from partnership and probated in his estate. And if all three general partners died the partnership was at an end, regardless. No similarity to a corporation.

4. *Transferability of beneficial interest.* No certificates or other evidence of partnership interest. A limited partner's interest could only be transferred by consent of general partners. Meaning agreement by them as found by Tax Court, *supra.* As Smith in Cali-

fornia Law Review, *supra*, said: (Quoted by respondents, petitioner stopped citing from Smith just before this paragraph.)

> "* * * But continuity, centralized management and something less than an absolute prohibition against all transfers of beneficial interests are fundamental functional traits of a corporation which cannot be eliminated by the parties without doing violence to well-established principles of corporation law."

Certainly this provision in partnership agreement meets all tests making it dissimilar to any corporate structure ever conceived.

5. *Limitation of Personal Liability.* The special partners here, similar to limited partners, under the uniform act had limited liability but general partners, whose interest was, in second partnership and intended in first, equal to all limited partner's interest had no limitation of liability. In addition, under then Washington law, *supra*, limited partner could lose his limited status by doing certain things.

In this case, general partners borrowed $80,000.00 and an additional $50,000.00 for partnership use. In event of disaster general partners could have been wiped out. What resemblance does this status bear to a corporation? To common stock as Petitioner suggests on Page 61 of his brief, when he asks you to think of general partners as common stockholders and special stockholders as preferred stockholders?

The answer is obvious. There is marked dissimilar-

ity between the limited partnership such as these at bar and a corporation.

Thirty-two states have adopted this limitation for special partners through the Uniform Limited Partnership Act. Certainly none of these legislatures contemplated that it was creating a form of corporation in so doing.

Respondents believe that in none of these five points does the respondents' partnerships approach that similarity to a corporation that sets them aside into a special category for tax purposes. As Justice Frankfurter said in the *Culbertson* case, *supra*, on Page 754:

> "We should leave no doubt in the minds of the Tax Court, of the Courts of Appeal, of the Treasury and of the bar, that the essential holding of the *Tower* case is that there is 'no reason' why the 'general rule' by which the existence of a partnership 'is determined' should not apply in tax cases where the government challenges the existence of a partnership for tax purposes."

Certainly these partnerships are challenged by the government pursuing a new and strange concept of tax liability as effects a partnership found by the Tax Court to be a true partnership and not an association taxable as a corporation.

The decision of the Tax Court should be affirmed in all respects.

Respectfully submitted,

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